CHAPTER II

REVIEW OF LITERATURE

2.1 INTRODUCTION

Review of literature enables the researcher to have a clear picture of what had been done in the particular field in recent years, thus avoiding duplication of work. It facilitates a clear view of what should be done in the field. Reviews have been collected from various sources like books, journals, unpublished thesis and e-resources. In this chapter, a detailed review of literature has been made to find out the research gap and to identify the relevant issues. It thoroughly investigates both National and International literature pertaining to the, financial management, accounting and reporting system, working capital management practices, capital structure, business environment and the problems faced by the Micro, Small and Medium Enterprises.

2.2 REVIEW OF LITERATURE

A brief summary of available literature on the subject is presented in this section.
2.2.1 STUDIES RELATING TO FINANCIAL MANAGEMENT

Abanis et.al (2013)\(^1\) carried out a study to determine the extent of financial management practices in Small and Medium Enterprises (SMEs) in selected district in Western Uganda. The objectives of the study were to determine the extent of financial management employed by SMEs as to the dimensions: Working capital management, investment, financing, financial reporting and analysis and accounting information systems. The study found out that the extent of financial management is low among SMEs. The theory of pecking order (Myers 1984) states that management has a preference to choose internal financing before external financing, was proved in this study in the aspects of SMEs using internally generated funds as compared to borrowed funds. The recommendation from the study stated that the Ministry of finance and economic planning; and the Bank of Uganda should provide a favourable platform to run SMEs business at a reasonable cost of financing.

Lakew and Rao (2013)\(^2\) investigated the effect of financial management practices and financial characteristics on profitability of business enterprises in the Jimma Town of Ethiopia. They pointed out that the efficiency of financial management practices and characteristics can bring about higher profitability.
Daskalakis et al. (2013)\textsuperscript{3} have investigated the level of access to various sources of finance of the small enterprises in Greece. Equity financing, Debt financing and grant financing were used in the evaluation. The study showed that firms rely heavily on their own funds and are reluctant to raise new capital from sources outside their family. Thus, there is reluctance in using new outside equity like venture capital and angel financing. Moreover, regarding debt financing, firms have limited access to debt but they had been using more debt than what they currently do. Finally regarding grant financing, micro and small firms have not been better informed to participate in the State grants and co-financed projects, which clearly indicates the informational gap in grant financing.

Fatoki (2012)\textsuperscript{4} has conducted a study on financial management practices of new micro enterprises in South Africa. He focused on financial planning and control, financial analysis, accounting information, management accounting, investment appraisal and working capital management. From the study it has been concluded that, financial management practices of Micro Enterprises are very weak in the areas of financial planning, analysis and control and investment decisions. Hence, the study suggested that training should be given in the areas of financial management, e-accounting and the evaluation of investment decisions.
Ramswamy (2012)\textsuperscript{5} studied the financial management practices of Micro Handloom enterprises predominantly run by women in a remote tribal cluster in Mizoram. He identified the sources of fixed capital and working capital for the enterprises and the problems related to finance faced by them.

Okafor (2012)\textsuperscript{6}, analysed the financial management practices of small firms in Nigeria impacted on their profitability, growth and survival. Accounting systems, financial management information, working capital management and budgeting practices have been evaluated. It has been found that accounting system and financial management information alone dominate the risk perception of fund providers. Hence, the study advised to employ the services of qualified accountants in order to upgrade their financial management practices and enhancing their overall performance.

Agyei-Mensah (2011)\textsuperscript{7}, attempted to: understand how working capital and capital budgeting decisions have been made in small firms and to identify the problems they face with regard to taking such decisions. The study has shown that the three most influential factors that did motivate the sample firms in pursuing sound financial management practices were: pressure from bankers, pressure from external accountants and pressure from providers of capital. Hence, the study recommended that small firms should disclose fully the financial position by keeping full set of information on their business transactions.
Karunananda and Jayamaha (2011) studied the financial practices among SMEs in Sri Lanka and the impact of financial practices upon business performance. The study revealed that there is no similarity among the financial practices followed by the SMEs under study. It showed that medium enterprises followed strict financial practises more than the small enterprises. Also those firms which comply with financial practices performed better than the SMEs who were not.

Azhar et. al. (2010) investigated the financial management components and techniques practiced by the SMEs in Malaysia. The findings of the study shows that three components of financial management to be categorized as core components practiced by the SMEs, that is, financial planning and control, financial accounting, and working capital management. Three other components which are financial analysis, management accounting, and capital budgeting can be categorized as supplementary components practiced by the SMEs due to the small percentage of the SMEs using these components in the management of their business.

Berry et. al (2002) stated that deficiencies in financial management have been repeatedly cited as a root cause of business failure. Two arguments are advanced for such deficiencies in SMEs. The first argument is that new accounting is not relevant and that SME
managers are unable to make use of accounting information and practices. The second argument is that the accounting ideas have been relevant to SMEs. But, a process of innovation combining both knowledge to overcome a barrier of belief and an external shock, are necessary. The finding of the survey suggests that its use does support business growth but innovation in accounting in SMEs require further research.

Agyei and Kofi Nicholas (2014)\textsuperscript{11} in their study revealed that most small scale businesses do not keep proper financial records and do not effectively manage their inventory and payables.

2.2.2 STUDIES RELATING TO ACCOUNTING SYSTEM

Rahamon and Adejare (2014)\textsuperscript{12} investigated the effect of accounting records kept by the Small Scale Enterprises. Found that there is a significant relationship between accounting records and small scale firm’s performance. He concluded that proper records keeping would lead to better financial performance of the Small Scale Enterprises. Moreover, it increases the chances of increase in the business operation and achievement of success and the provision of necessary information to enable the control of cash in the business.
Shahabi et al. (2014) explored the accounting practices of SMEs in Iran. The application of accounting information to support assessment of financial performance by SMEs in Iran is inefficient. The Government should conduct program to appraise SMEs to keep proper books and prepare final accounts.

Chelimo and Sopia (2014) established that there is a direct relationship between book keeping growth and profitability of SMEs. The study recommended that the Chamber of Commerce should organise seminars, symposiums and open forum that will teach entrepreneurs on how to keep proper written records.

Ntim et al (2014) have examined the various accounting and control systems applied in the Small and Medium Scale Enterprises (SMEs) in Ghana. The research findings showed the direct relationship between firm’s size and the adoption of accounting and control system. Also, the age of the business have direct influence on a firm’s adoption of formal accounting and control systems. The study also revealed that, tax authorities are the main users of SMEs financial statements. The researcher recommended that national regulators must develop specific accounting guidelines for SMEs and develop accounting training programmes for entrepreneurs in small business.
Amoako et al (2014)\textsuperscript{16} in his research paper, found that most of the SMEs do not keep complete accounting records as a result of numerous factors such as: lack of book keeping skills on the part of owners or managers and the high cost involved in adopting a good accounting system. They do not prepare annual reports at the end of the year.

Amoah (2014)\textsuperscript{17} conducted a study on the accounting practices of SMEs in Sunyani. The findings of the survey indicated that SMEs do not keep and maintain complete set of financial statements as reported by previous researchers such as Maseko and Manyani (2011) and McMahon (1999). It also recommended that Policy makers in accounting and regulators of SMEs should provide guidelines for the SMEs to capture the relevant accounting information in a mandatory manner and also training programmes in SMEs management and accounting should be put in place for the SMEs to acquire the needed skills in managing their business.

Smirat (2013)\textsuperscript{18} has conducted a study on the awareness level of financial management from the preparation of accounting reports and its information usage in the Small and Medium Enterprises in the Southern Districts of Jordan. The study revealed that significant number of Small Scale Enterprises use the single entry system because of its simplicity. Most of the enterprise owners or managers do not know about the
importance of keeping a good accounting record. Hence, the study recommended that good accounting practices will improve the effective operations of Small and Medium Enterprises.

Kalainathan and Vijayarani (2013)\textsuperscript{19} in their study entitled “Accounting system in Small Scale Enterprises: A Case Study” found that accounting system in the SSE is not good, but they have prime books to enter the transactions and also there is no legal requirement to prepare the accounting records regularly by the Small Scale Enterprises.

Rao (2013)\textsuperscript{20} has inferred in his study that there is positive relationship between adoption of proper accounting practices and reinvestments in MSME sector and profitability. Simplified procedures with lesser cost on cost accounting system are needed.

Olatunji (2013)\textsuperscript{21} in his research study showed that an effective accounting system in Small and Medium Enterprises has profound impact on their corporate performances. The study recommended that, higher education institutions should encourage collaborative studies to unravel the speciality of products to fit into Small and Medium Enterprises constraints.

Amoako (2013)\textsuperscript{22} explored the accounting practices of SMEs in Ghana. The results revealed that SMEs do not maintain proper books of accounts because: owners do not appreciate the need of keeping accounting records; lack of necessary accounting knowledge; and e
increase in the cost of hiring accounting professional. Further, proper accounting system will enable the banks to make a proper evaluation of SMEs, which would improve the accessibility towards credit. The study recommended that, the authorities should provide templates for accounting practices of SMEs.

**Maseko and Manyani (2011)** in his study investigated accounting record keeping practices for performance measurement employed by SMEs in Zimbabwe. The study revealed that due to lack of accounting knowledge and the increase in the cost of hiring professional accountants, SMEs do not keep complete accounting records. The regulators should come up with specific accounting guidelines for SMEs.

**Okoli (2011)** evaluated the accounting system of Small Scale Enterprises. He concluded that the Small Scale operators could not assess their performances effectively because of inadequate record keeping. Moreover, he showed that there is a need for adequate record keeping which will help the proprietors to keep track of the performance of these enterprises in order to enhance the profitability of Small Scale Enterprises and their continuity.

**Amidu et. al(2011)** in their study entitled, “E-Accounting practices among SMEs in Ghana” found that the SMEs put in place accounting softwares to generate their financial performance. The study
recommended that SMEs in Ghana adhere to good and standard accounting principles in their operations. The adoption of e-accounting ensures proper accounting practices as well as reversal good implications for entrepreneurs and SME managers.

Sathyamoorthi (2001)\textsuperscript{26} observed that, it is important to have a system of control over all business activities. A well-designed and properly implemented control system ensures: Protection of resources against waste and fraud; Accuracy and reliability in accounting data; and Success in the evaluation of the performance of the business.

2.2.3 STUDIES RELATING TO FINANCIAL REPORTING

Kofi et al. (2014)\textsuperscript{27} in their study revealed that non-existence of proper book-keeping and basic accounting procedures in Small Scale Enterprises in Ghana. Most Small Business Entities did not present financial statement for tax assessment, due to poor financial record keeping. High cost of hiring the service of trained accountant, lack of knowledge about financial report and it’s important to the business and lack of computerized accounting systems, were the challenges faced by the Small Scale Enterprises in Ghana.

McMahon and Davies (1994)\textsuperscript{28} established significant association between financial reporting and analysis and achieved growth
rates and financial performance. The following results were also found out: Enterprises that had more comprehensive reporting, in terms of both the number of statements obtained and their frequency, were more likely to employ financial analysis. Moreover, there is apparently no statistically significant association between rates of growth in turnover and employment achieved by participating enterprises and their historical financial reporting practices. Also, there appears no statistically significant association between achieved rates of growth in turnover, employment, and net profit and use of financial ratio analysis.

2.2.4 STUDIES RELATING TO WORKING CAPITAL MANAGEMENT

**Mensah (2012)** Small and Medium Enterprises relied on manual methods of inventory and majority do not know anything about Economic Order Quantity Model (EOQ). Careless working capital management practices is a major cause of SME failure. Poor Cash flow management, poor inventory control and bad debts or poor receivables management are the most internal problems of SME.

**Sundary (2011)** in his study revealed that there is poor liquidity in most small business in Nigeria and also poor record keeping system in most small firms, which reduces the ability of the firm. Most SMEs do not care about their working capital position. Most have only little regard for their working capital position.
Padachi and Howorth (2014)\textsuperscript{31} in their study showed that firms which claimed a more severely late payment focused more on credit management and pay more attention to working capital financing. Interestingly, the smaller firms may not be adopting formal analysis of Working Capital Management, not only because of resource constraint, but also due to lack of need. Financial institutions and policy makers need to focus on educating such owner-managers with necessary Working Capital Management knowledge.

Dumbu and Raphinos (2012)\textsuperscript{32} in their study found that majority of the Micro and Small Enterprises in the manufacturing sector in Masvingo Urban were not practicing sound Working Capital Management. They are involved in the limited application of the theories of Working Capital Management. Owners should receive financial management training, recruit suitable financial personnel and external use of professionals to manage the working capital issues in their firms, were the recommendations of the study.

Garcia-Teruel and Martinez-Solano (2010)\textsuperscript{33} studied the importance of trade credit which is an investment in accounts receivables. The result of the study showed that trade credit has an effect on levels of invested assets and consequently may have an important
impact on the profitability and liquidity of the firm. Moreover, granting trade credit improves sales for the firm, but it also increases the costs due to the increase in investment in the current assets. Empirical results revealed that factors such as: age of the firm, cost of external financing, rate of turnover of assets, and gross profit margin, which were initially could be considered as determinants of the level of trade credit granted, do not affect the levels of accounts receivable.

Niskanen and Niskanen (2006)\textsuperscript{34} point out that firms with a greater capacity to generate internal funds, have more resources available and can offer more finance to their customers. The study revealed a positive relationship between trade credit and internal financing for Finnish SMEs, operating in a bank-based system similar to that encountered by Spanish SMEs.

Berger and Udell (2005)\textsuperscript{35} analysed the effects of SMEs credit availability. The results show that credit availability is given to SMEs on the basis of, treating them as opaque borrowers and not informational transparent borrowers. It is argued that this treatment had been given to the SMEs because of the lack of formal financial management practices in SMEs. But it is stated that large financial institutions will not be at any disadvantage by providing credit to informational opaque SMEs.
Marfo-Yiadom (2002)\textsuperscript{36} observed that, theoretically, a cash budget serves two purposes; first they alert the financial manager to future cash needs. Second the cash flow forecasts provide a standard, or budget, against which subsequent performance can be judged.

Pike and cheng (2005)\textsuperscript{37} found that small and medium firms and younger firms that have worse reputations need to use more trade credit in order to ensure their sustained production. Moreover, customers may exert their purchasing power to buy on credit when the suppliers are small numbers, so that they can reduce the risk of uncertainty about the quality of the products purchased. Thus, there exist a negative relationship between the accounts receivables and the firm size.

Uwonda et al. (2013)\textsuperscript{38} highlighted limitations in the utilization of cash flow in SMEs in areas like: cash flow projection, tax planning and budgetary control, and determination and interpretation of financial statement. The SMEs must apply value analysis engineering and process engineering, total quality management, JIT and Benchmarking, tools for the continuous improvement of quality. The SMEs must also employ: competent people who can design business plan, prepare cash flow projections and cash budgeting. Because, budgetary control improve the SMEs credit policies.

Monisola (2013)\textsuperscript{39} examined the different inventory management practices and assessed their impact on the inventory decisions in SMEs.
It is found that perpetual inventory method has not been in use and also poor emphasis on a structured inventory process. Hence the study recommended improving the knowledge of SME personnel about quantitative inventory decision models and the application of ICT for data management.

**Das and Dey (2004)** in their study on small business in cachar district of Assam in 2002-03, observed that the small and micro enterprises followed a liberal credit policy but were largely unaware of the techniques of financial management and book keeping.

### 2.2.5 STUDIES RELATING TO CAPITAL STRUCTURE

**Uddin (2014)** in his study entitled “Problems faced by Micro Small and Medium Enterprises in Raising Debt Capital”, found that the major problem in raising debt capital is faced due to the requirements of collateral securities. Thus, the chance of obtaining debt financing by MSMEs has been very low.

**Nishanth and Zakkariya (2014)** in their research paper, identified the various barriers faced by the MSME units while raising finance. It also identified the various sources of finance- other than banks. The study concluded that barriers for raising finance can be reduced to some extend if the owners make efforts to increase their knowledge and better utilisation of the available Government schemes.
Singh and Singh (2014)\textsuperscript{43} in their study entitled “Problems related to the financing of Small firms in India” found that the MSMEs depended for their initial capital on internal sources, as they have accessibility problems in getting external debt or equity financing. They identified the factor affecting financial management of MSMEs. The key issues under financial management include: shortage of own financial resources for innovation, difficulty in access to finance via bank loans, Government Subsidies, and the slowness in getting loan applications, processing and sanction, Lack of Government policies relating to subsidies and reliefs Tax. Effective management on these issues can lead to the better performance of MSMEs under the competitive environment.

Singh and Janor (2013)\textsuperscript{44} in their paper analysed the corporate financing patterns adopted by SME sector in the northern region of India. They found that the SME sector is not adopting any particular form of capital structure. The need as well as the internal factors of an enterprise determine the choice of capital structure.

Mishra and Brahme (2011)\textsuperscript{45} in their study, found that the major reason for not seeking credit by the SMEs lack of information about credit sources and were due to the lack of availability of collaterals documents as security.
Yadev (2013)\textsuperscript{46} studied the financial leverage and capital structure planning in Small-Scale Industries. He found that, Small Scale Industries owners are not at all familiar with the term financial leverage.

Sung and Zeng (2008)\textsuperscript{47} examined an empirical evidence of small business financing in China. A sample of 60 small businesses from three cities of china were taken. The study revealed that at the initial stage of their functioning the, small business in China have used their own sources and also the finances from relatives and friends. But at the later stages, small business has used bank finance. The reason being that banks in China follow strict formalities to be fulfilled by the small businesses, namely, taxation, submission reports and, accounting and credit rating scores documentations.

Das (2002)\textsuperscript{48} observed that the SME entrepreneurs faced problem of paucity of working capital. This is because of: long and complicated procedures in sanction of loans, high interest rates, requirement of collateral security and a considerable time gap in the sanctioning and actual disbursement of loans. She further pointed out the problems faced by the banks, have been the lack of proper maintenance of audited accounts, lack of proper maintenance of audited accounts, lack of proper project planning and improper utilization of loans by enterprises.
Nyanamba et al. (2013)\textsuperscript{49} carried out a research on the determinants of capital structure among micro enterprises. The determinants identified were: access to capital markets, size of the business, profitability of the business and lender’s attitude towards the firm. They concluded that, micro-enterprises prefer borrowing from various external sources.

2.2.6 STUDIES RELATING TO BUSINESS ENVIRONMENT

George (2012)\textsuperscript{50} in his study titled “Business Environment Analysis and Growth of Small Enterprises in Kerala”, examined the impact of business environmental factors upon entrepreneurship in the Micro and Small Manufacturing Enterprises in Kerala. From the study it is concluded that the impact of macro business environmental factors is unfavourable to the manufacturing enterprises in the State of Kerala.

Chittithaworm and Islam (2011)\textsuperscript{51} revealed that SMEs Characteristic, Customer and Markets, the way of doing Business and Cooperation, Resources and Finance, and External Environment have significant positive effect on the Business Success of SMEs in Thailand. Management know-how, Product and Services, and Strategy were found to have no significant effect on the Business Success of SMEs in Thailand. External environment factor play a very important role as well for firm success. Social network, government support, and legality, are the key strategic dimensions in the external environment of business success.
2.2.7 STUDIES RELATING TO MSMEs

Biswa (2014)\textsuperscript{52} analysed the various constraints faced by the MSMEs, with reference to banking sector. The study concluded that, though banks are catering the needs of the MSME sector through various schemes specifically drafted for the MSMEs, still there is a huge gap between the demand of credit by the MSME sector and actual supply of credit to this sector by banks and other financial institutions. Since, role of MSMEs in India economy cannot be overlooked, it’s imperative for the government and RBI to cater the financial needs of MSME sector and help them being competitive in this globalized economy.

Garg and Walia (2012)\textsuperscript{53} in their study entitled “Micro, Small and Medium Enterprises(MSMEs) in Post reform India: Status and Performance” found that the significant growth of MSMEs have been taken place over a period of time and this sector is the major donor to GDP, employment and exports in Indian economy.

Katoch (2012)\textsuperscript{54} examined the growth and performance of MSMEs in terms of employment, exports, production and growth in number of units. The study found that the MSME sector has registered a good performance in terms of number of units, production, employment and exports. The study recommended that establishment of central marketing and export agency and opening of Research and Development Centres can help to develop the MSMEs in India.
Kumar and Gugloth (2011) in their study entitled “Competitive Performance of Micro, Small and Medium Enterprises in India”, found that the MSMEs have performed well and enabled the country to make the process of providing additional employment and rural industrialization.

Kumar et al., (2009), analysed the growth and development of the Indian SSI, contribution of MSMEs in the industrial production and GDP and the opportunities and challenges faced by the MSMEs in India. It has been concluded that MSMEs found difficult to sell their products in the domestic and international markets because of increasing competition. The study recommended that, Indian MSMEs need to upgrade their technology and put more emphasis on innovation.

Rathod, C. B. (2007) described the importance of small scale industrial sector and also the contribution of Indian small scale entrepreneurs in world economy. He studied the growth and pattern of the SSI sector and identify the reasons for success or failures, to evaluate the impact of globalization on SSIs and export opportunity, to identify the barriers and constraints that SSIs were facing to cope with globalization. The study concluded that both opportunities and challenges were raised as the impact of globalization on Indian Industry as a whole and the small scale sector in particular. The study
has suggested that need for simplified legal and regulatory framework, good governance, sufficient and accessible finance, suitable infrastructure and competitive environment.

**Subrahmanyabala, M.H. (2004)** highlighted the impact of globalization and domestic reforms on small-scale industries sector. The study concluded that small industry had suffered in terms of growth of units, employment, output and exports. Researcher highlighted that the policy changes had also thrown open new opportunities and markets for the small-scale industries sector. The researcher suggested that the focus must be turned to technology development and strengthening of financial infrastructure in order to make Indian small industry internationally competitive and contribute to national income and employment.

**Goyal et. al (2012)** analysed the sickness in MSMEs in India. They studied the causes for sickness and quantum of sickness among MSMEs in India. Inspite of the incentives and facilities offered under Industrial Policy and efforts to promote large number of MSMEs, over the years, large number of units have been confronted with a number of problems, which turn them into sick. They concluded that, there has been a need to identify sickness and remedial measures before the sickness takes place.
2.3 RESEARCH GAP

Review of earlier studies on MSMEs has helped the researcher to identify the research gap. The previous studies covered mainly the general aspects of working capital management, accounting practices and financial management. Many researchers have been done on the financial management with regards to large enterprises. Besides, other focusing Small and Medium Enterprises (SMEs) have been carried out in various parts of the country not included the micro enterprises. From the detailed literature review, it is understood that, financial management practices which have been largely ignored among Micro Enterprises. Because most MSMEs consider financial management as an issue relevant only to large enterprises. Many MSMEs tend to neglect the importance of financial management in their enterprises. However the characteristic that make the Micro, Small and Medium Enterprises are different compared to those that make large enterprises. Thus the need to carry research on the topic “Financial Management Evaluation of the Micro, Small and Medium Enterprises in the Tirunelveli Municipal Corporation”.

2.4 CONCLUSION

In this chapter, the review of past studies relating to the, financial management, accounting and reporting system, working capital management practices, capital structure, business environment and the problems faced by the Micro, Small and Medium Enterprises had been reviewed.
REFERENCES


