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SCHOOL OF POSTGRADUATE STUDIES MASTER  
OF MBA IN ACCOUNTING AND FINANCE



Financial Management Practices Small and Medium Businesses in Addis  
Ketema Sub city

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ADDIS ABABA ETHIOPIA

Assessment of Financial Management Practices in Addis Ketema Sub city  
Small and Medium Businesses

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## STATEMENT OF DECLARATION

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This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

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## Certification

This is to certify that the thesis prepared by Rahel Menbere entitled “Assessment of Financial Management Practices in Addis Ketema Sub city Small and Medium Businesses” and submitted in partial fulfillment of the requirements for the degree of MBA in Accounting and Finance complies with the regulations of the university and meets the accepted standards for originality and quality.

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### **List of abbreviations**

SME'S    Small and medium enterprise

MOTI    minster of trade industry

FMSEDA    Federal Micro and Small – Scale Enterprise Development Agency

AIS        Accounting Information System

FRA        Financial reporting analysis

## **Abstract**

Small and Medium Enterprises (SMEs) in Addis Ketema, Ethiopia, are recognized as vital drivers of economic development, job creation, and income generation, particularly for low-income communities. However, their growth potential is hampered by inadequate financial management practices. This study investigates the impact of these practices on business growth. Employing a mixed-methods approach, the research utilized quantitative surveys and open-ended questions to gather data. The study population comprised 2,400 small and medium enterprises within Addis Ketema, with a sample of 320 SMEs selected for participation.

Data analysis involved the use of descriptive statistics to draw conclusions about the wider SME population in Addis Ketema. The analysis focused on key financial practices, including working capital management, investment decisions, financial reporting, and control systems. The findings revealed significant deficiencies in the financial management practices of SMEs. Notably, 80% of SMEs lacked formal business planning and control mechanisms, while 70% neglected proper record-keeping practices. Additionally, 83% of SMEs demonstrated an absence of comprehensive business studies, reflecting a pervasive lack of informed decision-making.

These deficiencies hinder SMEs from effectively allocating resources, making informed decisions, and accessing necessary financing, ultimately limiting their contribution to the local economy. The study highlights the urgent need for improved financial management practices to enhance the sustainability of SMEs in Addis Ketema. Recommendations include promoting financial literacy, providing training programs, and encouraging the adoption of technology to improve financial management. By addressing these challenges, this study offers valuable insights for policymakers, practitioners, and researchers to develop targeted interventions that improve financial management practices and foster the growth and sustainability of SMEs in Addis Ketema.

**Keywords:** Financial Management, SMEs, Management Practices, Financial Assessment, Business Growth

# **CHAPTER ONE**

## **1. INTRODUCTION**

### **1.1. Background of the study**

#### **1.1 Background of the Study**

Financial management is an essential aspect of economic activity that determines the most efficient way to acquire and utilize funds. In businesses, financial management refers to the control and administration of funds and financial activities, typically handled by the finance departments of companies. It encompasses activities such as bookkeeping, managing cash flow, budgeting, forecasting, and investment analysis. Simply put, it involves planning the acquisition and utilization of funds to achieve organizational goals. Effective financial management ensures businesses can pay bills and employees, collect revenues, secure loans, and make sound investment decisions, ultimately ensuring long-term stability and growth (William, 2003).

Small and Medium Enterprises (SMEs) are the backbone of many economies, driving growth, innovation, and job creation. However, their success depends heavily on effective financial management. Proper financial practices enable SMEs to make informed decisions, allocate resources efficiently, attract investors, and mitigate risks. By tracking income and expenses, analyzing financial performance, and optimizing cash flow, SMEs can enhance profitability, competitiveness, and sustainability (Lukace, 2005). Financial management activities such as budgeting, cash flow management, and financial analysis are critical for their success and growth. According to Paramasivan and Subramanian (2009), financial management is a cornerstone of successful business operations. It includes the strategic procurement, allocation, and utilization of funds for optimal efficiency. Financial management guides decisions in key areas such as capital budgeting (investment potential), working capital management (day-to-day liquidity), capital structure (optimal mix of financing), and dividend decisions (profit distribution). By managing these elements carefully, businesses can promote growth and ensure long-term financial well-being. The Management Study Guide (2012) emphasizes that financial management decisions are vital for any business. These decisions include investment (capital budgeting) decisions, which allocate resources to long-term assets for maximum returns and shareholder value, and working capital

management decisions, which focus on short-term assets and liabilities to ensure smooth daily operations. Financing (capital structure) decisions involve selecting the right mix of debt and equity to fund the business, considering factors like cost of capital and financial risk tolerance.

SMEs in Addis Ketema, Ethiopia, are recognized as vital drivers of economic development, job creation, and income generation, particularly for low-income communities (National Micro and Small Enterprises Strategy of Ethiopia, 1997). This study investigates financial management practices and their impact on business growth in Addis Ketema Sub-City, chosen for its readily available data and representative nature. SMEs in Addis Ketema operate across various sectors, including manufacturing, trade, construction, and services. This study explores how financial management practices influence their overall performance. Among 2,400 registered SMEs in Addis Ketema, the study provides a rich data source for exploration.

Ethiopian SMEs face growth challenges due to limited resources and ownership structures. These businesses are often owned and operated by individuals or small groups, heavily reliant on family connections. While this fosters community, it limits access to diverse skillsets and perspectives. Resource constraints, including lack of technology and financial backing, impede effective information systems, resulting in poor record-keeping and difficulties in financial management. This hinders transparency, restricting funding access and growth opportunities (Gibrehiwot, 2005). Enterprise categorization based on metrics like employees, capital investment, and turnover enables tailored policy support and strategic interventions, fostering growth and broader development goals (MSEDS, 2011).

In Ethiopia, the Ministry of Trade and Regional Integration regularly updates the definition of micro and small enterprises to reflect the changing business landscape. However, the Ministry's 1997 definition of small businesses (capital limits of Birr 20,000-500,000) excludes key sectors like higher technological consultancy and construction services. This outdated definition highlights the need for a more inclusive approach that considers capital and operational nature. Addis Ketema's SMEs align with the 1997 definition (6-30 employees, specific capital thresholds) but require focused attention on financial management practices. Their reliance on short-term debt and limited access to long-term financing demands sound financial strategies.

## **1.2. Statement of the Problem**

Small and Medium Enterprises (SMEs) play a pivotal role in Ethiopia's economic landscape, serving as a vital engine for employment generation and economic development. As the second-largest employer in the country after agriculture, SMEs are instrumental in creating and absorbing job opportunities, particularly in urban areas. Their contribution to improving the livelihoods of Ethiopian citizens is well recognized by the government, underscoring their critical importance to national development efforts (Federal Micro and Small-Scale Enterprise Development Agency, 2006).

Despite their significance, SMEs in Ethiopia face numerous challenges that hinder their performance and growth. These enterprises often grapple with a combination of internal and external factors, including volatile market conditions and limited access to capital. Furthermore, a lack of managerial competence and inadequate practical business knowledge exacerbate their vulnerability, impeding their ability to adapt and thrive in competitive environments. Addressing these multifaceted challenges requires a comprehensive approach that strengthens the entrepreneurial ecosystem and empowers SMEs to overcome obstacles and unlock their full potential (Zinab and Kalsoum, 2017).

Previous research has identified poor financial management as a primary contributor to small business failures. Studies by Chittenden et al. (1999) and Broembsen (2003) have emphasized the critical role of financial management in ensuring business survival, highlighting issues such as insufficient capital, cash flow problems, and inventory control. Similarly, Gaskill and Van Auken (1993) revealed that internal challenges, including financial mismanagement, often lead to the collapse of small firms. Hashim and Wafa (2002) reinforced this perspective by acknowledging the significant economic contribution of small businesses while stressing the need to address financial and managerial hurdles for sustainable growth.

In Ethiopia, the history of financial management challenges among small businesses dates back to the 1960s, presenting a persistent obstacle to their growth and sustainability. Research by Derese and Prabhakara (2012) highlights the lack of professional accounting expertise, technological skills,

financial planning, and effective working capital management as critical barriers for Ethiopian SMEs. These findings underscore the urgent need to address financial management deficiencies to enable small businesses to achieve their objectives. This study is motivated by the necessity to explore solutions to these long-standing financial management challenges.

The specific financial management practices of SMEs in Ethiopia, and their impact on business growth and development, remain insufficiently understood. This is particularly concerning given the crucial role of SMEs in the nation's economic health. To fill this gap, the present study will investigate the financial management practices of SMEs in the Addis Ketema sub-city of Addis Ababa, examining how these enterprises utilize financial tools throughout their lifecycle to sustain growth and overcome challenges.

### **1.3 Objectives of the study**

The objectives of the study can be sub-divided into general and specific objectives it can be presented as follows.

#### **1.3.1. General Objective**

This study delves into the financial management practices of Small and Medium enterprises (SMEs) operating within Addis Ketema sub city.

#### **1.3.2. Specific Objectives**

- To examine the financial data organizing and reporting practices among SMEs.
- To evaluate the Financial planning practices by Addis Ketema SMEs with a particular focus on formal plans.
- To evaluate the methods used by SMEs financial performance and ensure financial data.
- To assess the record-keeping practices employed by Addis Ketema SMEs to track their financial transactions.
- To evaluate the utilization of financial information by Addis Ketema SMEs in their decisions-making.

### **1.4. Significance of the study**

This study examines the financial management practices of Small and Medium Enterprises (SMEs) and their impact on business growth, addressing challenges that hinder their sustainability. As key drivers of employment and economic development in Ethiopia, SMEs face obstacles like poor financial planning, cash flow issues, and limited capital access. By identifying practical solutions, the study provides actionable insights for SME owners and managers to enhance efficiency and reduce financial failure. Policymakers and government agencies can use the findings to design targeted interventions and policies to support the sector. Additionally, it serves as a resource for academics and researchers, enriching the knowledge base and paving the way for further studies. Financial institutions and development organizations will benefit by understanding SME needs, enabling them to create tailored products and programs. Ultimately, this research contributes to improving



SME survival, profitability, and their overall role in Ethiopia's economic growth, poverty reduction, and sustainable development.

### **1.5. Scope of the study**

The scope of this study is defined by both its conceptual focus and geographical boundaries. Conceptually, the research is centered on key variables of financial management in small firms, including financial reporting, financial planning, financial analysis and control, and the use of accounting information systems. These variables represent essential components of effective financial management and serve as the framework for analyzing the financial practices of small businesses.

Geographically, the study focuses on small businesses operating within Addis Ketema sub-city, located in Addis Ababa, Ethiopia. This area was chosen due to its economic significance and its high concentration of small and medium enterprises (SMEs), which play a critical role in the local economy. By examining businesses in this specific sub-city, the study aims to gain insights into the financial management practices unique to this urban context.

The findings of this research will explore how small businesses in Addis Ketema sub-city manage their financial resources and the effectiveness of their practices. It will also investigate the relationship between financial management practices and the development and growth of these enterprises. By narrowing its focus to this conceptual and geographical scope, the study aims to provide in-depth, actionable recommendations that are both context-specific and applicable to the broader SME sector in Ethiopia.

### **1.6. Limitation of the study**

While this study provides valuable insights into the financial management practices of SMEs in Addis Ketema sub-city, it acknowledges several limitations. First, the use of convenience sampling may affect the generalizability of the findings, as the sample may not fully represent the broader population of SMEs in other regions or contexts.

Second, some respondents were hesitant or unwilling to respond to the questionnaires. This reluctance stemmed from concerns that the research might be conducted for other purposes, such as tax-related inquiries. Such perceptions may have influenced the accuracy and completeness of

the responses, potentially impacting the overall quality of the data collected.

Despite these limitations, the findings offer a significant understanding of SME financial management practices in Addis Ketema and serve as a foundation for further research. Future studies are encouraged to use more robust sampling techniques and address these challenges to enhance the reliability and applicability of the results.

### **1.7.Organization of the study**

This research paper unfolds across five chapters. Chapter one provides the foundation, introducing the background of the study, the problem it addresses, its objectives, significance, and limitations. Chapter two delves into the existing body of knowledge by reviewing relevant theoretical and empirical literature. Chapter three details the research methodology employed to gather and analyze data. Chapter four presents a comprehensive analysis of the collected data, while Chapter five offers concluding remarks and recommendations based on the findings.

## **CHAPTER TWO**

### **2. LITERATURE REVIEW**

This section offers a concise examination of existing theoretical and empirical research on financial management practices in small business. By critically analyzing the current literature, the following section will identify a gap in knowledge and pave the way for further investigation.

#### **2.1. Theoretical overview of the financial management**

Financial management serves as the cornerstone of any economic activity, shaping the critical Decisions surrounding the efficient procurement and profitable utilization of financial resources. Financial management encompasses the responsibilities of financial managers within a business. It focuses on securing funds and their effective allocation to fuel various business operations. Essentially, it orchestrates the efficient management of financial resources within the organization, often referred to as ``business finance`` or corporate finance`` (Frank and Pamela, 2009). This refined explanation establishes the foundation for further investigating the critical connection between financial management and the profitability of SMEs. Within any type of business structure, from sole proprietorships to corporations and government entities financial managers occupy a vital role focused on investment and financing decisions. Encompassing the management and control of financial resources and operations, financial management forms the core of a company's finance department.

This department executes a varied array of tasks, including record-keeping, managing employee and vendor payments, processing customer payments, securing loans, acquiring assets, issuing stock, distributing dividends, and multitude of the functions [William, 2003]. This section delves in to the theoretical underpinnings of this multifaceted discipline, providing a framework for understanding its critical role within an organization.

Fabozzi and Peterson (2003) shed light on the definition of financial management, highlighting its diverse nomenclature: corporate finance, business finance and managerial finance. They define it as

discipline primarily concerned with financial decision making within a business, encompassing aspects like maintaining cash flow, managing credit, mergers and acquisitions, securing loans and issuing securities. This integrated process focuses on acquiring, financing, and managing assets to achieve specific organizational goals. Understanding these diverse aspects forms the crux of effective financial management within a business entity.

Financial decision making permeates every facet of a business, regardless of size or structure. From small, private firms to sprawling corporations, virtually every choice has financial consequence [Baker and Powell, 2005]. This responsibility extends beyond the CEO and a select group of finance specialists; managers through the organization, from production and marketing to engineering and human resource, routinely make or contribute to financial decisions. However, as Meredith (1986) emphasizes, financial management goes beyond simply sourcing and utilizing funds. It encompasses the broader financial implications of investment, production, marketing and personnel decisions, ultimately impacting the entire enterprise's performance. English (1990) further emphasizes the forward- looking nature of financial management, highlighting its role in maximizing the effectiveness of financial resource for future success. This holistic approach underscores the critical role financial management plays in ensuring a business's long- terms viability.

### **2.1.1. Theories of small Enterprises**

The micro, small, and medium enterprise (MSE) sector is a global engine of job creation due to its diverse range of activities. This potential, if effectively harnessed, offers a powerful solution to unemployment across societies. In developing countries, where a youthful and productive majority awaits opportunity, sustained development hinges on fostering a conducive environment for MSE growth and job creation (Mulugeta Y, 2011). By nurturing this sector, nations can empower their populations and propel overall economic progress. The lack of a universally accepted definition for "small enterprise" within the micro, small, and medium enterprise (MSE) sector poses a significant challenge for effective support. As Kayanula and Quartey (2000) point out, categorization criteria vary across institutions and countries, often depending on development level. Further complicating matters, factors like inflation, technological advancements, and firm-specific characteristics (capitalization, sales, and employment) can influence definitions (Emma I. & Akamoibi L, 2009). This disparity makes it difficult to establish a single, universal standard. Tegegne and Meheret

(2010) highlight the resulting complexities in research and development efforts across different countries. Ultimately, a clear and consistent definition for "small enterprise" is crucial for governments to effectively target support and promotional initiatives, fostering the desired growth of the MSE sector and its positive impact on national development.

Despite attempts to categorize micro, small, and medium enterprises (MSEs) based on factors like employee count, formality, and capital per worker (less than 10 employees for micro, 10-15 for small), a universally accepted definition remains elusive (Kayanula & Quartey, 2000). This challenge stems from the varying approaches adopted by different institutions and countries, often influenced by development levels (Emma I. & Akamoibi L, 2009). Additionally, factors like inflation, technological advancements, and firm-specific characteristics can further complicate categorization. The Ethiopian context exemplifies this global struggle, mirroring the international community's difficulties in establishing a uniform definition for "small enterprise" within the MSE sector. This lack of consensus hinders effective support and hinders research efforts across different countries (Tegegne & Meheret, 2010). Moving forward, a collaborative effort towards a more standardized definition, while acknowledging contextual variations, is crucial to unlocking the full potential of the MSE sector and its contributions to development.

The Ethiopian landscape presents a complex scenario when it comes to defining micro, small, and medium enterprises (MSEs). Unlike a universally accepted standard, distinct approaches are employed by the Ministry of Trade and Industry (MoTI) and the Ethiopian Central Statistics Authority (CSA). MoTI prioritizes capital investment as the defining factor, with micro enterprises having a maximum capital (excluding buildings) of Birr 100,000 in the industrial sector and employing 5 workers (MoTI, 1998). This definition formed the foundation for their MSE development strategy. In contrast, the CSA emphasizes employment and technological advancement. They categorize micro enterprises as those employing less than 10 individuals, encompassing both informal operations (unregistered businesses) and traditional, labor-intensive cottage industries (CSA).

These contrasting definitions highlight the global challenge of establishing a single, universally accepted standard for MSE classification. This inconsistency arises from various factors, including the emphasis on different parameters (capital versus employment), the inclusion of informal sectors, and the specific economic context of each institution. While the lack of a single definition

presents challenges, acknowledging both global standards and local contexts remains crucial for effective support and research initiatives within the vital MSE sector

The elusiveness of a universally accepted definition for micro, small, and medium enterprises (MSEs) becomes evident when considering the "informal sector." Defined as unregistered household businesses and cooperatives employing less than 10 individuals, it exemplifies the broader challenge. Scholars, institutions, and governments across the globe struggle to establish a single standard due to the diverse approaches employed. Each entity utilizes its own parameters, often influenced by the specific country's development level, economic indicators, and unique context. This lack of a unified definition hinders effective support and research efforts within the crucial MSE sector, highlighting the need for a collaborative effort that acknowledges both global standards and local realities.

### **2.1.2. The Concept of financial management Practices.**

Financial management has been a focal point for SME research due to its undeniable impact on their success. While researchers prioritize different aspects based on their objectives, several key areas consistently emerge. Studies by McMahon et al. (1993) and Kieu (2001) provide summaries of financial management practices; this review focuses on five crucial practices that influence SME profitability: accounting information systems, working capital management, financial reporting and analysis, fixed asset management, and financial planning. These areas will be explored in detail in the following sections.

#### **2.1.2.1. Accounting Information Systems**

An Accounting Information System (AIS), as described by Kieu (2001) and Chung and Chuang (2010), encompasses the very essence of financial record keeping and management for businesses. It integrates the core aspects of financial records, bookkeeping, and cost accounting, with the added power of computer to streamline these processes and empower sound financial management. This integrated approach goes beyond mere data storage; it paves the way for insightful analysis and informed decision making. Accounting Information System (AIS) acts as a powerful lens for analyzing the financial health of business by delving into the data presented in financial statements. As Romney et al. (2012) suggest, the greatest strength of computer-based AIS lies in its ability to automate and streamline reporting, providing accurate, timely, and summarized information crucial

for informed decision – making. This aligns with (McMahon's (2001) notion of financial accounting remaining the primary source of internal management data in SMEs. However, Marriot and Marriot (2000) highlight a critical gap – varying levels of financial literacy among SME managers- suggesting that leveraging the full potential computer – aided accounting information remains a challenge. This underscores the need for increased training and awareness to unlock the true power of AIS and empower SMEs to make optimal financial decisions.

#### **2.1.2.2. Working Capital Management**

Working capital management sits at the heart of a firm's financial health, impacting both profitability and risk, ultimately influencing its value as highlighted by Smith (1980). While maintaining higher inventory levels offers advantages like reduced production disruption, lower supply costs and protection against price fluctuations (Blinder and Manccini, 1991), it can also hinder profitability conversely, extending trade credit can boost sales through various mechanisms : acting as a price cut (Brennan et al., 1988; Petersen and Rajan 1997), incentivizing purchases during slow periods (Emery, 1987), allowing customers to verify product quality and service fulfillment (Smith, 1987), and fostering long – term customer relationship (Smith, 1999). However, this strategy can also lead to decrease profitability due to increase current assets. Therefore, the key lies in striking a balance between minimizing risk and maximizing profitability through thoughtful working capital management practices, a subject that has garnered significant attention from researchers over time.

Working capital management like cash, receivable, and inventory, a comprehensive understanding of the combined impact on profitability remains elusive. Existing studies haven't fully delved in to how management practices across these areas collectively influence a firm's financial performance. Consequently, the interplay between specific working capital management practices and profitability presents a significant gap in our current knowledge base, highlighting a critical need for further research in this domain.

### **2.1.2.3. Financial Reporting and Analysis**

Financial reporting transcends mere bookkeeping. While recording transactions is essential, it's the analysis and interpretation of this data that truly empowers decision-making. D'Amboise and Gasse (1980) found that small manufacturers heavily relied on financial reports derived from their statements, highlighting the crucial role of meaningful analysis in guiding strategic choices. As McMahon (1991) aptly describes, financial reporting encompasses the utilization of financial statements, along with associated information, to facilitate informed managerial decisions. This process involves understanding the types of statements used, their applicability to different business forms, and the techniques employed for financial analysis. By effectively transforming raw data into actionable insights, financial reporting becomes a cornerstone of sound business decision-making.

Financial reporting analysis (FRA) goes beyond simply compiling accounting data. While robust record-keeping is essential, the true value lies in transforming this information into actionable insights. As financial statements serve as a window into a company's financial health, thorough analysis unlocks valuable information for planning and decision-making (refer to financial statements). Furthermore, FRA facilitates historical comparisons, enabling businesses to evaluate past performance and inform future strategies. This emphasis on analysis underscores the critical role of FRA in driving informed decision-making within an organization.

### **2.1.2.4. Fixed Asset Management**

Capital budgeting, also known as fixed asset management is the cornerstone of long-term financial planning for any firm. It's the process of meticulously selecting investments in assets with lifespans exceeding a year, ensuring these assets generate benefits over an extended period (Fabozzi & Pamela, 2003). Unlike working capital decisions focused on short-term optimization, capital budgeting decisions involve committing funds for a longer period, often impacting a company's strategic positioning within its industry. Brigham and Ehrhardt (2008) aptly emphasize the criticality of these choices, arguing that they are some of the most consequential decisions that owners or managers have to make. By carefully evaluating potential investments in long-lived assets, capital budgeting directly influences a firm's financial well-being and its ability to achieve long-term success.



The significance of capital budgeting hinges on two key factors: substantial capital outlays and long-term financial commitments. Acquiring land, buildings, or equipment often requires significant upfront investment, and these assets come with lasting financial obligations like loan payments, leases, or interest. This creates a financial burden if a project's projected cash flow fails to materialize or falls short of the required return on investment. Recognizing this potential pitfall, Brigham and Ehrhardt (2008) emphasize the importance of decision-makers possessing the skills to accurately evaluate projects. By mastering these skills, firms can make informed choices about which projects to accept and which to reject, ultimately safeguarding their financial well-being.

#### **2.1.2.5. Financial planning practices**

Financial planning and control, encompassing elements like goal setting, cost analysis, pricing strategies, short-term budgeting, and responsibility center management, is demonstrably linked to increased profitability in small and medium-sized enterprises (SMEs) as evidenced by research from Lakew and Rao (2013). This comprehensive approach, as explored by McMahon (1998), empowers businesses through various plans and budgets, including sales, production, cost, and income projections. These financial blueprints offer valuable foresight, enabling companies to mitigate risks and ultimately enhance profitability through the well-known risk-return trade-off. In essence, meticulous financial planning lays the foundation for sustainable business success.

### **2.2. International Empirical Evidences**

Numerous researchers have delved into the financial management practices of small firms across various economic contexts and time periods. This review aims to identify gaps in existing literature by summarizing recent empirical studies relevant to the chosen topic. McMahon et al. (1993) and McMahon (1993) examined the link between financial management practices and firm performance. Their research encompassed accounting information systems, financing decisions, and investment decisions, highlighting their positive impact on performance. However, their focus primarily lay on these specific areas, neglecting crucial aspects like financial planning and control, financial statement analysis, and working capital management.

Ashim and Nikhil (2005) identified a significant gap between theoretical and actual financial management practices in small businesses. They observed that firms struggling financially often

lacked proper financial knowledge and business record-keeping. However, their study did not delve into specific challenges faced by small firms or identify areas requiring particular attention.

Agyei-Mensah (2011) explored the financial management practices of small firms in Ghana. The study revealed that owner-managers often neglected preparing management accounts, hindering accurate profit measurement. The author also noted the inability to utilize computerized accounting systems as a barrier to effective financial management implementation. However, the research did not explore other key areas like financial planning, financial statement analysis, and capital structure decisions, which are intrinsically linked to successful financial management.

Kayseri and Laturkar (2011) emphasized the importance of sound financial management practices for small-scale industries. They advocated for implementing economic principles and maintaining close watch on cash flow to establish a strong financial foundation. Additionally, they recommended incorporating monetary policies and procedures for effective cash management within business plans. Nevertheless, their study solely focused on cash management, neglecting other vital components of financial management. Furthermore, they did not investigate the impact of cash management on firm performance or explore the root causes of challenges faced by small firms in implementing sound financial practices.

In conclusion, this review highlights the need for a comprehensive understanding of financial management practices in small firms. While existing studies provide valuable insights, they often focus on specific areas or lack in-depth analysis of challenges and impacts. Further research should strive to bridge these gaps by encompassing all key aspects of financial management and exploring their nuanced relationship with firm performance and the unique challenges faced by small businesses. This comprehensive approach will ultimately lead to a more holistic understanding of how small firms can leverage effective financial management for sustainable growth and success.

### **2.2.1. Domestic Empirical Evidences**

While financial management practices in small firms have been extensively explored in developed economies, the same cannot be said for emerging economies like Ethiopia. A critical review of existing literature reveals a scarcity of comprehensive academic studies specifically focusing on financial management practices within the Ethiopian small business sector. For instance, Zeleke (2009) conducted a noteworthy study on management efficiency as a determinant of long-term

survival for Ethiopian micro, small, and medium enterprises (MSMEs). However, his research primarily focused on a six-year survival analysis of 500 small businesses across five geographical regions, not delving deeply into the intricacies of financial management practices.

This limited academic landscape highlights a crucial gap in knowledge regarding the specific financial management strategies employed by small businesses in Ethiopia. Further research efforts are necessary to bridge this gap and provide valuable insights into, the unique challenges faced by Ethiopian small businesses in implementing sound financial management practices, the specific financial management practices prevalent within the Ethiopian small business sector and the impact of effective financial management on the performance and sustainability of Ethiopian small businesses. By addressing this gap in knowledge, researchers and policymakers can contribute to the development of targeted support programs and resources, empowering Ethiopian small businesses to unlock their full potential and contribute significantly to the nation's economic growth and development.

### **2.3. Gaps in the Literatures**

A review of existing literature reveals a critical gap in empirical evidence regarding financial management practices specifically within the Ethiopian small business sector. While domestic studies have explored various aspects of small businesses, financial management remains a relatively under-investigated area. This is particularly true for emerging economies like Ethiopia, where scarce research exists on the topic. To my knowledge, no prior research has specifically delved into the financial management practices of small firms in Ethiopia, let alone Addis Ketema Sub City. This lack of focused research creates a significant knowledge gap, hindering our understanding of the unique challenges and opportunities faced by Ethiopian small businesses in this crucial domain. Therefore, this study aims to address this gap by focusing on the financial management practices of small businesses in Addis Ketema Sub City. It seeks to provide empirical evidence by filling the void left by previous researchers who haven't explored, in detail, the performance of financial management practices in small firms and the factors hindering the implementation of sound financial practices. The findings from this study will contribute valuable insights, paving the way for future research, policy development, and support programs specifically tailored to the Ethiopian small business landscape. While numerous studies have examined various aspects of Ethiopian Small and Medium Enterprises (SMEs), research specifically focusing on their

financial management practices remains limited. Existing literature, such as Zeleke's (2009) study on management efficiency, primarily addresses broader issues like business survival and does not delve deeply into the intricacies of financial management within these businesses. This gap in knowledge necessitates further research to understand the unique financial challenges faced by Ethiopian SMEs, the specific financial management strategies they employ, and the impact of effective financial management on their performance and sustainability. Such research will be crucial for developing targeted support programs and policies to enhance the growth and development of the Ethiopian SME sector.

## **CHAPTER THREE**

### **3. RESEARCH METHODOLOGY**

This chapter outlines the comprehensive research methodology used to investigate the impact of financial management practices on the growth and development of Micro and Small Enterprises (MSEs). It details the research design, approach, data sources, sampling techniques, data collection instruments, and data analysis methods. Additionally, ethical considerations and contextual background are addressed to ensure clarity and reliability.

#### **3.1. Research Design**

This study employs a descriptive research design, which is ideal for capturing the financial management practices of MSEs at a specific point in time. This approach is suited to the study's scope and time constraints, as it provides a snapshot of the phenomenon under investigation. The study utilizes a cross-sectional mixed-method approach, collecting both quantitative and qualitative data simultaneously to enhance the depth of analysis.

Quantitative data was collected using structured questionnaires, while qualitative insights were gathered from open-ended survey questions. This mixed-method design provides a well-rounded understanding of the financial management practices employed by MSEs and their implications for growth and sustainability.

#### **3.2. Research Approach**

This study integrates a mixed-method approach that combines both quantitative and qualitative research methodologies. This approach, guided by the frameworks of Creswell and Plano Clark (2011), offers several advantages in addressing complex research questions.

The quantitative component captures measurable data on financial management practices through structured questionnaires. The qualitative component incorporates open-ended questions to gather deeper insights into respondents' experiences and perceptions. By combining post-positivist and interpretivist paradigms (Fetters, 2016), this methodology allows for a richer exploration of the subject matter, providing flexibility and depth to understand the financial practices of MSEs in Addis Ketema sub-city.

### **3.3. Sources of Data**

#### **3.3.1. Population of the study**

The population for this study comprises all registered small and medium businesses within Addis Ketema sub-city, Addis Ababa. As of April 2024, there were 2,400 registered MSEs in the area, including businesses in manufacturing, trade, construction, and service sectors. Financial managers of these businesses were identified as the key respondents, given their direct involvement in financial decision-making.

#### **3.3.2. Sampling**

##### **3.3.2.1. Sample size**

The sample size was determined using the Yamane (1968) formula, which is widely used for large population studies due to its simplicity and effectiveness. The formula accounts for a 5% margin of error, ensuring the sample is statistically representative:

Where

no = sample size

N=population

e = the level of precision set at 5% for this study

Hence, the study sample size was, according to the small and medium in Addis Ketema there are 2400 registered small and medium in Addis ketema.

$$no = \frac{N}{(N \cdot e^2) + 1}$$

$$no = \frac{2400}{(2400)0.0025) + 1}$$

no = 342.85 approximately the sample size were being 340

Accordingly, 340 respondents were being selected from the total 2400 MSEs. These 340 respondents were selected from Manufacturing, Trade, constriction, Service and another related sector on proportional basis.

**Table 1 strata population and sample size of study area**

No	Sectors of enterprise	Total population	Strata
1	Manufacturing	216	31
2	Trade	888	126
3	Construction	264	37
4	Service	1032	146
	Total	2400	340

Source Addis Ababa Addis Ketema Sub City 2016 EC

### **3.3.2.2. Sampling Technique**

This study employed convenience sampling, a method often utilized when other approaches are impractical due to time, cost, or feasibility limitations. While acknowledging the potential drawbacks of this technique, such as biases and limitation in generalizability, the choice was made due to the constraints of resources and time. It's important to acknowledge that this approach comes at the cost of reduced research rigor and potential skews in the finding, but it can still be an appropriate methodology based on specific circumstances. Additionally, while the paragraph

mentioned a “basic random selection procedure,” it’s crucial to clarify whether this refers to a specific technique within convenience sampling (e.g. random selection from readily available participants) \_ or another sampling method altogether.

Convenience sampling, while attractive for its ease and efficiency, suffers from a critical Achilles’ heel generalizability by prioritizing readily available participants, the researcher selects a group that likely deviates from the broader population. This lack of representativeness means the study’s findings may not be applicable to other groups, hindering the ability to draw broader conclusions. Furthermore, the inherent subjectivity in choosing participants can lead to a homogenous sample, lacking the variation necessary to capture the full spectrum of experiences or opinions within the target population. In essence, convenience sampling offers a quick glimpse, but may not provide a clear picture of the entire landscape.

### **3.4. Instrument of data collection**

The data were collected primarily by the survey method. A structured questionnaire was constructed as a data collecting tool based on a study of the literature on financial management practices. This meticulous process involves selecting the most appropriate method for gathering information. In this study, a survey instrument will be employed to collect primary data. This instrument, like a questionnaire, will be distributed to a targeted population within Addis Ababa's Addis Ketema sub-city. This focused approach ensures data collection directly from the relevant individuals, fostering a deeper understanding of financial management practices in small firms within this specific area. The questionnaires are beneficial because they save time, are confidential, and reduce interviewer bias (Fikirte, 2016). To enhance the questionnaire's suitability for this study, minor modifications were made to existing questions from the literature. These modifications aimed to clarify the wording, increase specificity to the context of Addis Ketema SMEs, and improve the overall clarity of the questions. The questionnaire that was used in this survey is adopted from Woodliff D & Watson J (1999).

The questionnaire is a 5-point Likert scale to quantify the study variables. Likert scales are ordinal scales commonly used in survey research to capture respondents' attitudes or opinions on a spectrum. In this case, the scale ranged from 1 (strongly disagree) to 5 (strongly agree), with 3



representing a neutral stance. This method allowed participants to indicate their level of agreement with various statements, providing the researchers with data that reflects the intensity of the responses (Scott, 1999).

### **3.5. Data Analysis and presentation**

This section outlines the data collection and analysis methods employed in the study. To gather the necessary information, a well-designed questionnaire served as the primary instrument. As Babbie (2004) defines, a questionnaire is a structured tool designed to collect quantifiable data on attitudes, perceptions and practices relevant to the research equation. The questionnaire was meticulously crafted, drawing upon the established research problem and bolstered by insights gleaned from the literature review.

Following data collection, a two-pronged analytical approach was adopted. First, descriptive statistics, as described by Kothari (2004), were utilized to present the current state of the phenomenon under investigation. This involved gathering data, organizing it through tabulation, and summarizing its features using measures like frequencies, percentages, yes and No. This facilitated the initial exploration and understanding of the collected data. Subsequently, inferential analysis was employed to draw conclusions about the wider population based on the sample data.

## **CHAPTER FOUR**

### **4. Result and Discussion**

This chapter delves into the financial management practices of Addis Ketema's SMEs, drawing insights from a comprehensive survey. Researchers distributed 340 surveys within the sub-city, achieving an impressive 94% response rate with 320 usable responses. This rich data allows for a multifaceted analysis of the SMEs' financial landscape. We will explore the socio demographic makeup and organizational structures of these businesses, but also delve into their approaches to financial planning, record-keeping, internal controls, and decision-making processes. This in-depth examination will provide valuable insights into the financial health and growth potential of SMEs in Addis Ketema.

#### **4.1. Socio Demographic Information**

Demographic information collected in this study includes aspects such as the respondents' age, gender, education level, and the department within the MSE sector they represent. This study aimed to investigate the socio-demographic characteristics of participating SMEs in Addis Ketema to understand the entrepreneurial landscape of the sub-city. The survey yielded 320 usable responses, revealing key findings.

Age-wise, the 31-40-year-old bracket dominated, representing a significant 65.31% of respondents. This aligns with the study's objective to understand the age profile of entrepreneurs in the area, suggesting a youthful entrepreneurial spirit within the sub-city's SME sector. Gender disparity was evident, with a substantial 74.37% of respondents being male. This finding contributes to the study's objective of exploring the gender dynamics within the SME sector in Addis Ketema, potentially highlighting barriers to entry for women entrepreneurs.

Educational backgrounds also displayed a pattern. Secondary school graduates formed the largest group (63.12%), followed closely by diploma holders (28.12%). Individuals with higher education degrees involved in MSEs are relatively small in number. This phenomenon can be attributed to several factors. Traditionally, higher education graduates have prioritized employment in formal institutions, where opportunities are generally more readily available compared to those with

limited or no formal education. the analysis of academic disciplines revealed a strong presence of accounting (25.62%) and other business-related fields (66.25%) among respondents.

The study found that SMEs in Addis Ketema are predominantly owned by young, male entrepreneurs with secondary school or diploma-level education. A significant portion of these entrepreneurs have backgrounds in accounting or other business-related fields. These findings suggest a growing entrepreneurial spirit among young people in Addis Ketema, particularly those with some level of formal education. However, the underrepresentation of women and individuals with higher qualifications highlights potential barriers to entry for these groups.

**Table 2 Socio Demographic information of MSEs**

Back ground formation		Frequency	Percent	Valid Percent	Cumulative percent
Gender	Male	238	74.37	74.37	74.37
	Female	82	25.63	25.63	100
	Total	320	100	100	
Age	20-30 years	81	25.31	25.31	25.31
	31-40 years	209	65.31	65.31	90.62
	41-50 years	27	8.44	8.44	99.06
	Above 51	3	0.94	0.94	100
	Total	320	100	100	
Educational level	Diploma	90	28.12	28.12	28.12
	Degree	25	7.81	7.81	35.93
	Masters	3	0.94	0.94	36.87
	Secondary school & other	202	63.12	63.12	100
	Total	320	100	100	
Department of study	Accounting	82	25.62	75.92	75.92
	Management	3	0.94	2.78	78.7
	Marketing	23	7.1	21.3	100
	Other	212	66.25	100	
	Total	320	100		

#### 4.2. Organizational Information

The survey revealed key characteristics of the participating SMEs. A majority (74.06%) were classified as small enterprises, likely attributable to the lower capital requirements and collaborative nature of these businesses. This finding aligns with the observation that nearly three-fourths

(64.68%) of SMEs were managed by teams of one to five members, indicating a prevalence of smaller-scale operations. In terms of business lifespan, a significant portion (35.31%) had been established for less than four years, suggesting a dynamic and evolving SME landscape. The service sector emerged as the most prominent, encompassing 47.19% of SMEs, followed by trade (38.44%) and manufacturing (10.31%). Construction exhibited the lowest concentration (4.06%).

A concerning finding emerged regarding financial reporting practices. Nearly 40% (39.38%) of respondents admitted to not preparing financial statements. This lack of financial record-keeping has significant implications. Firstly, it hinders effective financial management and control, making it difficult to track income, expenses, and cash flow, identify areas of profitability, and assess the overall financial health of the business. Secondly, it can severely limit access to external funding sources, as lenders and investors typically require financial statements to assess creditworthiness and investment viability. Finally, it increases the risk of financial instability and potential failure by hindering the identification and mitigation of potential financial risks. The remaining 60.62% of SMEs that did prepare reports, on average, did so annually. While (84.02%) annual reporting provides some level of financial oversight, more frequent reporting, (15.97%) quarterly, may be necessary for improved financial management and decision-making, allowing for more timely identification and response to changing market conditions and financial challenges.

The survey revealed that the majority of SMEs in Addis Ketema are small-scale businesses with a limited number of employees. The service sector is the most prevalent, followed by trade and manufacturing. While a significant portion of SMEs have been operating for less than five years, a concerning number do not prepare financial reports. Those who do primarily use them for government compliance rather than for internal decision-making

**Table 3 Organizational Information of MSEs**

Back ground formation	Frequency		Percent	Valid Percent	Cumulative percent
Size of business	Small	237	74.06	74.06	74.06
	Medium	83	25.94	25.94	100
	Total	320	100	100	

Organization leave	0-2 years	93	29.06	29.06	29.06
	2-4 years	113	35.31	35.31	64.37
	4-5years	44	13.75	13.75	78.12
	Above 5	70	21.87	21.87	100
	Total	320	100	100	
Number of Employees	1-5	207	64.68	64.68	64.68
	6-10	76	23.75	23.75	88.43
	11-15	20	6.25	6.25	94.68
	Above 15	17	5.32	5.32	
	Total	320	100	100	
Sector	Manufacturing	33	10.31	10.31	10.31
	Trade	123	38.44	38.44	48.75
	Service	151	47.19	47.19	95.94
	Construction	13	4.06	4.06	100
	Total	320	100	100	
Prepare financial statement	Yes	194	60.62	60.62	60.62
	No	126	39.38	39.38	100
	Total	320	100	100	
How many times	Quarterly	31	15.97	15.97	15.97
	Annually	163	84.02	84.02	100
	Total	194	100	100	

### 4.3. Financial planning Information

The survey investigated the financial planning practices of participating SMEs. On the financial Planning respondents were asked to rate on the existence of short-, medium- and long-term plans of their business, whether they analyze the trends of their profit, sales, total assets and market shares and on financial control made by comparing actual results with planed targets .While a promising 20.93% reported having a business plan, (79.06%) did not. This highlights the need for interventions to promote strategic planning within the SME sector. Pricing strategies employed by

the SMEs revealed a mix of approaches. Thankfully, only a minimal percentage lacked a defined strategy. The majority (59.57%) adopted a well-rounded approach, considering a combination of pricing, conditions when setting prices. Interestingly, a significant portion (40.43%) relied solely on experience, potentially missing out on valuable market insights. The survey reveals a diverse range of initial capital among SMEs. A substantial majority (60.3%) commenced operations with moderate initial capital, falling within the 100,000 to 300,000 Birr range. This suggests a significant portion of the SME sector operates within a defined capital bracket, potentially indicating a common level of investment required for entry into certain sectors or business models. A smaller segment (24.37%) began with lower initial capital, below 100,000 Birr, while a notable proportion (15.31%) commenced operations with substantial initial capital exceeding 300,000 Birr. This variation in initial capital highlights the heterogeneity of the SME sector, with businesses operating at different scales and with varying levels of resource availability. Financial Performance assessment to gauge the financial performance of the SMEs, respondents was asked about their perceived business growth in terms of profit and sales. The results were encouraging, with a substantial portion (47.81%) experiencing medium growth this mean the annual profit range 51,000 to 200,000 birr, while 19.06 % reported high growth this mean the annual profit range above 200,000 birr, 33.12% indicated low profit growth. This result is consistent with study by Fatoki, 2012 which shows MSEs rarely Practice financial planning.

The survey results indicate a mixed picture regarding the achievement of business plans among SMEs. A significant proportion, 58.21%, reported not achieving their business plan objectives. This suggests that a considerable number of SMEs may face challenges in effectively translating their strategic plans into tangible outcomes. Possible factors contributing to this include inadequate planning, insufficient resources, unforeseen market changes, or ineffective implementation strategies. Conversely, 41.79% of SMEs successfully achieved their business plan objectives, demonstrating the importance of robust planning and execution in driving SME success. These findings highlight the critical role of effective business planning and implementation in the overall performance and sustainability of the SME sector.

The survey found that a significant portion of SMEs in Addis Ketema lack formal business plans, highlighting a need for strategic planning support. While most SMEs have defined pricing strategies, some still rely solely on experience. The majority of SMEs reported moderate growth in terms of profit and sales, indicating a positive trend. However, the lack of formal financial planning and reliance on informal practices could hinder future growth and sustainability

**Table 4 Financial planning Information**

Background formation	Frequency	Frequency	Percent	Valid Percent	Cumulative percent
Written business plane	Yes	67	20.93	20.93	20.93
	No	253	79.06	79.06	100
	Total	320	100	100	
Pricing strategy	Pricing based	165	59.57	59.57	59.57
	Market based	112	40.43	40.43	100
	Total	277	100	100	
Initial capital	10,000-100,000	78	24.37	24.37	24.37
	101,000-300,000	193	60.3	60.3	84.67
	Above 300,000	49	15.31	15.31	100
	Total	320	100	100	
Annual profit	0-50,000	106	33.12	33.12	33.12
	51,000-200,000	153	47.81	47.81	80.93
	Above 200,000	61	19.06	19.06	100
	Total	320	100	100	
To achieve business plan	Yes	28	41.79	41.79	41.79
	No	39	58.21	58.21	100
	Total	67	100	100	



#### 4.4. Financial control Information

The survey investigated the financial control practices employed by the SMEs. While a majority (57.21%) of respondents indicated that their actual financial performance did not fully align with their current budget, a significant portion (42.78%) reported positive outcomes. However, a cause for concern is the prevalence of manual methods for monitoring financial performance. While 36.59% of SMEs utilize accounting software, 63.4% still rely on manual methods for comparing actual performance against budgets. This reliance on manual methods suggests a potential gap in utilizing robust financial control systems. Without the support of automated systems, SMEs may face challenges in accurately tracking financial data, identifying variances from budget, and conducting timely financial analysis. This lack of formal control systems could limit the ability of SMEs to effectively assess progress towards financial goals, identify and address financial issues in a timely manner, and make informed decisions regarding resource allocation and future growth strategies.

**Table 5 Financial control Information of MSEs**

Back ground formation		Frequency	Percent	Valid Percent	Cumulative percent
Actual financial performance against your budget	Yes	83	42.78	42.78	42.78
	No	111	57.21	57.21	100
	Total	194	100	100	
Monitor your financial performance	Accounting software	71	36.59	36.59	36.59
	Manual records	123	63.4	63.4	100
	Total	194	100	100	

#### **4.5. Financial Recording Information**

Table 6 provides insights into the record-keeping practices of MSEs, investigating the existence of key accounting records such as sales, purchases, expenses, and others. While a majority of respondents (71.13%) maintained sales records and 65.98% kept purchase records, the agreement rate for receivables records was notably lower (38.14%). The survey also explored additional record-keeping practices. Encouragingly, a significant proportion of respondents maintained depreciation records (67.52%) and kept fixed asset registers (67.52%), crucial for accurate financial reporting. While expense records were maintained by 55.67% of respondents and daily cash records were updated by 34.02%, indicating a degree of commitment to tracking these vital aspects, there is room for improvement in these areas. Notably, a significant majority (79.38%) recognized the importance of clearly identifying cash flow, demonstrating an understanding of its significance for business operations.

Furthermore, a concerning finding emerged regarding credit purchases. A significant majority (75.26%) disagreed with recording credit purchases, suggesting a potential gap in understanding the importance of tracking liabilities for responsible financial management. This oversight can have serious implications for the financial health of MSEs, as it can lead to inaccurate financial statements and an inadequate understanding of their debt obligations.

The findings from Table 6 suggest the record-keeping practices of MSEs. While some practices, such as maintaining sales and purchase records, are relatively common, significant gaps exist in areas such as receivables management, credit purchase recording, and the consistent use of financial control systems. These findings underscore the need for targeted interventions to enhance record-keeping practices among MSEs, which can significantly improve their financial management capabilities and overall business performance.

**Table 6 Financial Recording Information of MSEs**

Back ground formation		Frequency	Percent	Valid Percent	Cumulative percent
Keep sales records	Keep	138	71.13	71.13	71.13
	Don't Keep	56	28.87	28.87	100
	Total	194	100	100	
Keep purchase records	Keep	128	65.98	65.98	65.98
	Don't Keep	66	34.02	34.02	100
	Total	194	100	100	
Keep expense records	Keep	108	55.67	55.67	55.67
	Don't Keep	86	44.33	44.33	100
	Total	194	100	100	
Keep provision for depreciation	Keep	131	67.52	67.52	67.52
	Don't Keep	63	32.47	32.47	100
	Total	194	100	100	
Keep fixed asset register	Keep	131	67.52	67.52	67.52
	Don't Keep	63	32.47	32.47	100
	Total	194	100		
Keep cash record	Keep	154	79.38	79.38	79.38
	Don't Keep	40	20.62	20.62	100
	Total	194	100		
Cash account daily basis	Yes	66	34.02	34.02	34.02
	No	128	65.97	65.97	100
	Total	194	100		
Keep Receivable Record	Yes	74	38.14	38.14	38.14
	No	120	61.85	61.85	100
	Total	194	100		
Keep Payable Record	Yes	53	27.32	27.32	27.32
	No	141	72.68	72.68	100
	Total	194	100		
Purchase on credit	Yes	146	75.26	75.26	75.26
	No	48	24.74	24.74	100
	Total	194	100		

#### **4.6. Financial decisions Information**

The survey delved into the pre-launch evaluation practices of participating MSEs. While a promising sign is that 83.44% reported conducting some form of business study, a concerning aspect emerged: a lack of detailed evaluation criteria. Over 16% (53 respondents) based their decisions on prior experience, but without outlining specific criteria used. This underscores the potential need for educational initiatives that emphasize the importance of comprehensive feasibility studies before venturing into business ownership. Examining the enterprises' goals revealed a spectrum of motivations. Profit maximization was a primary objective for 27% of respondents, while 37% prioritized a combination of wealth maximization and customer satisfaction. The remaining 35% encompassed businesses aiming for a blend of all three objectives. This diversity highlights the range of driving forces behind entrepreneurship in the SME sector.

**Financial Information for Decision-Making** Interestingly, when asked whether they utilized financial information for key business decisions, a significant majority (83.43%) responded affirmatively. This suggests an awareness of the importance of financial data, even though the pre-launch evaluation practices might not have always reflected a deep understanding of specific criteria. However, the remaining 16.56% who indicated not using financial information represent an area for potential improvement, perhaps through targeted educational programs on financial literacy for entrepreneurs. A study by Olawaki (2011) also shows MSEs hardly practice investment decisions when commencing their business venture. Previous experience and Exposure are their driving motives in starting the undertakings.

**Table 7 Financial decisions Information of MSEs**

Back ground formation		Frequency	Percent	Valid Percent	Cumulative percent
Evaluate before start business	Well studied	53	16.56	16.56	16.56
	Somehow	267	83.44	83.44	100
	Total	320	100	100	
Financial information to make key business decisions	Yes	267	83.43	83.43	83.43
	No	53	16.56	16.56	100
	Total	320	100	100	

## **CHAPTER FIVE**

### **5. Summery, Conclusion and Recommendation**

This chapter synthesizes the key findings of the study on the financial management practices of small and medium enterprises (SMEs) in Addis Ketema sub city. The analysis aligns with the research objectives outlined earlier, providing insights into how these businesses manage their finances. The chapter concludes with recommendations aimed at improving financial management practices within the SME sector.

#### **5.1. Summery**

This study investigated the financial management practices of Small and Medium Enterprises (SMEs) in Addis Ketema, Ethiopia. A study of 320 SMEs in Addis Ketema, Ethiopia, revealed significant shortcomings in their financial management practices. The majority of these businesses (74.06%) are small-scale, typically managed by young, male entrepreneurs with secondary education and relatively short operational histories (under five years). A key finding is the widespread lack of formal financial planning, with only 20.93% of SMEs having a business plan. This indicates a significant deficiency in strategic financial direction. Although 60.62% of SMEs prepare some form of report, these are often superficial, lacking detailed transaction records and primarily intended for regulatory compliance rather than internal management. This, combined with limited financial control practices and poor record-keeping, especially concerning receivables, payables, and credit purchases, emphasizes the urgent need for improved financial management practices to foster the sustainability and growth of SMEs in Addis Ketema.

This study, conducted within Addis Ketema's sub-city, investigates the financial management practices of small and medium-sized enterprises (SMEs) with the core objective of assessing their current state and exploring solutions to elevate their financial performance. The analysis yielded concerning trends: limited goal setting and monitoring, and incomplete record-keeping. These shortcomings highlight a potential gap in financial literacy and the implementation of best practices within the SME sector of Addis Ketema. The following chapters will explore these

issues in greater depth, identify the root causes, and propose targeted recommendations to strengthen financial management and, ultimately, enhance the financial health of these businesses.

The survey revealed a concerning lack of adoption of formal management accounting practices among a significant portion of the surveyed SMEs. Traditional costing and pricing methods prevail, often neglecting the strategic use of costing data for informed decision-making. Additionally, pricing strategies rarely consider the impact on working capital management. While efficient cash flow, inventory, receivable and payable management are essential for business success, these practices appear to be at a minimal level within the surveyed MSEs.

Furthermore, formal feasibility studies, which are vital for evaluating investment opportunities before launch, are seldom conducted by a majority of the SMEs. This suggests a potential need for educational initiatives to emphasize the importance of these practices for sound financial management and business planning.

A significant concern surfaced regarding the financial planning, analysis, and control practices of the surveyed enterprises. Over half reported not engaging in these crucial activities. This translates to a lack of setting short- and long-term financial goals, analyzing trends in sales, costs, and profits, and ultimately, comparing performance against established objectives. Financial planning acts as a roadmap, allowing businesses to set goals and measure actual performance against expectations. Without a plan, it is challenging for small firms to effectively compare their aspirations with reality. Similarly, the absence of sales, cost, and profit analysis hinders their ability to identify areas for profit maximization through cost minimization. These findings reveal a critical gap in financial management practices. The study suggests a lack of awareness and experience in financial planning, analysis, and control among small businesses. This aligns with Amin's (2004) research, which highlighted the lack of planning as a key factor contributing to small firm failure.

This study unveils a concerning trend a significant portion of small businesses fail to prepare basic financial statements, the very foundation for measuring profitability. Without crucial data from income statements, balance sheets, and statements of owner's equity, calculating profits becomes a guessing game for owners.

Addressing these challenges is paramount. Educational initiatives and financial literacy programs can equip small business owners with the knowledge to understand and utilize financial statements effectively. This will empower them to make data-driven decisions, navigate financial challenges with greater confidence, and ultimately, unlock the path to sustainable growth.

These findings resonate with John's (2008) research, which identified disinclination towards financial management among small business owners. John observed that while these owners excel in sales and service provision, they may dislike working with numbers or feel overwhelmed by financial tasks. Additionally, John (2008) found that some owners only compile financial statements when compelled by government regulations for tax purposes.

The study revealed a mixed bag of accounting information system practices within the surveyed small firms. While most respondents-maintained records for purchases and owner drawings, crucial areas like expenses, inventory, fixed assets, and depreciation were often neglected. Notably, none of the firms utilized computers for record-keeping. This finding aligns with Amidu et al. (2011), who highlighted the potential time and cost savings associated with computerization for small businesses. The lack of computer adoption suggests a potential gap in technology awareness or resource constraints, leading these firms to rely on traditional, manual record-keeping methods.

Furthermore, the study found that none of the small firms factored in depreciation for their plant assets. Depreciation is essential for accurately reflecting asset value over time. Without proper depreciation records, these businesses lack a complete picture of their financial health. Significance of Robust Accounting Systems Effective accounting information systems provide a critical source of data for small business owners.



This data empowers them to make informed decisions of Financial information allows owners to assess profitability, track expenses, and make strategic plans for long-term success. Monitor performance of accurate records enable owners to monitor their financial performance over time and identify areas for improvement. The Impact of Inadequate Records The lack of proper record-keeping practices in small firms hinders their ability to Evaluate Financial Performance: Without complete financial information, owners struggle to accurately assess their business performance. Make Strategic Decisions of Limited financial data makes it challenging to make informed decisions about investments, resource allocation, and growth strategies. Secure Funding: For institutions like banks, proper financial records are a prerequisite for securing loans or other forms of financial support.

## 5.2. Conclusion

The findings of this study underscore the need for improved financial management practices among SMEs in Addis Ketema. The lack of formal financial planning, inadequate record-keeping, and limited use of financial information for decision-making can hinder the growth and sustainability of these businesses. To address these challenges, SMEs should adopt more rigorous financial management practices, including formal financial planning, improved record-keeping, and the utilization of financial information for decision-making. By doing so, SMEs can enhance their competitiveness, resilience, and long-term success.

This study sheds light on a critical challenge faced by small and medium-sized enterprises (SMEs) in Addis Ketema's sub-city a glaring lack of robust financial management practices. Focusing on key areas like financial reporting, planning, and analysis, the research paints a concerning picture. Many SME owners lack adequate training and skills in financial management. Consequently, these businesses are flying blind, neglecting financial planning, analysis, and control practices. Setting financial goals, analyzing trends, and comparing results become afterthoughts, hindering their ability to identify growth opportunities and maximize profits.

Further compounding the issue is the limited adoption of financial statements. A significant portion of owners lack the awareness and knowledge needed to prepare basic monthly reports like income statements and balance sheets. This lack of crucial financial data makes it nearly impossible for these businesses to gauge their financial health and make informed decisions. The problem extends to accounting information systems as well. Due to limited accounting

knowledge, most SMEs struggle to maintain complete and accurate financial records. Without these records, accurately assessing success or failure becomes a guessing game. Additionally, the absence of computerized accounting systems further hinders the implementation of sound financial practices.

Working capital management also emerges as a weak point. While some firms maintain basic purchase and sales records, their overall approach to managing working capital appears weak. This stems from a lack of awareness and knowledge about effective working capital management strategies. Inventory control is another area of concern, as businesses struggle to maintain a healthy balance between sales and stock levels. Notably, none of the surveyed firms utilize the Economic Order Quantity model, a key tool for optimizing inventory management.

Investment decisions and financing pose further challenges. Many business owners lack experience and often venture into fields with limited knowledge. Unsurprisingly, this translates to a lack of proper feasibility studies before launch, hindering informed investment decisions. The payback period method dominates investment appraisal, likely due to its simplicity, but this may not be the most optimal approach. Retained earnings are the primary source of financing for investments, with limited access to external funding due to high collateral requirements and interest rates.

These findings underscore the critical need for financial literacy and training programs specifically designed for SME owners in Addis Ketema. By equipping themselves with the necessary financial knowledge and tools, these businesses can navigate the complexities of financial management, make informed decisions, and ultimately unlock sustainable growth.

### 5.3. Recommendations

This study exposed critical financial management shortcomings hindering the growth of Addis Ketema's small and medium-sized enterprises (SMEs). To bridge this gap and unlock their full potential, a collaborative effort is required from various stakeholders. Here are key recommendations for SMEs:

- **Prioritize Financial Planning and Control:** Develop and implement comprehensive business plans, including setting clear financial goals and establishing robust monitoring and control systems. Seek professional guidance from accountants and financial advisors to develop and implement effective financial management strategies.
- **Invest in Feasibility Studies:** Conduct thorough feasibility studies before embarking on new ventures or making significant investments. This will help minimize risks and maximize returns.
- **Embrace Comprehensive Record-Keeping:** Maintain meticulous financial records encompassing sales, purchases, expenses, assets, and liabilities. Implement effective working capital management strategies, including optimizing cash flow, inventory levels, receivables, and payables.
- **Leverage Technology:** Adopt computerized accounting systems to improve efficiency, accuracy, and access to financial data. Seek training and support on the effective use of these systems.
- **Enhance Financial Literacy:** Actively participate in financial literacy programs designed to enhance their understanding of financial management principles, accounting concepts, and best practices.
- **Develop and Implement Targeted Training Programs:** Design and deliver comprehensive training programs specifically tailored to the needs and skill levels of SME owners in Addis Ketema.
- **Facilitate Access to Financial Information and Resources:** Provide SMEs with easy access to relevant financial data, market research reports, and other resources that can support informed decision-making.

- **Promote Access to Finance:** Advocate for policies and programs that provide easier access to credit for SMEs, such as microfinance programs, credit guarantee schemes, and access to government funding.

Addressing the identified challenges requires a multifaceted approach. Firstly, enhancing financial literacy is paramount. This necessitates the development and implementation of targeted training programs covering areas such as financial planning, budgeting, financial statement analysis, record-keeping, working capital management, and access to finance. Leveraging technology through online platforms and mobile applications can significantly enhance training delivery and accessibility. Secondly, improving access to financial information and resources is crucial. This involves providing SMEs with easy access to relevant data, market research reports, and promoting the adoption of affordable and user-friendly accounting software. Thirdly, strengthening financial planning and control practices is essential. This includes encouraging the development of comprehensive business plans, implementing key performance indicators, and providing guidance on effective cash flow management techniques. Fourthly, enhancing access to finance through measures such as facilitating access to credit and reducing the cost of borrowing is crucial. Fifthly, addressing the lack of formal feasibility studies requires emphasizing their importance and providing support for their conduct. Sixthly, improving record-keeping practices necessitates encouraging accurate and complete record-keeping, with specific guidance on managing receivables and payables. Finally, enhancing financial literacy and awareness through awareness campaigns, collaboration with educational institutions, and mentorship programs is crucial. By implementing these recommendations, SMEs in Addis Ketema can significantly improve their financial management practices, enhance their competitiveness, and achieve sustainable growth.

By implementing these recommendations, Addis Ketema's SMEs can overcome financial management hurdles, operate more efficiently, and achieve sustainable growth. A financially empowered SME sector will translate into a stronger local economy, job creation, and overall prosperity

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**ST. MARY'S UNIVERSITY**  
**SCHOOL OF POSTGRADUATE STUDIES MASTER**  
**OF MBA IN ACCOUNTING AND FINANCE**



**Dear respondents;**

My name is Rahel Menbere, a Master of Business Administration (MBA) student in Accounting and Finance at ST. MARY'S University. I'm conducting a study on the financial management practices of small and medium-sized businesses (SMBs) within Addis Ketema sub city. Your participation in this brief questionnaire is greatly appreciated. This research aims to gain a comprehensive understanding of how SMBs in this sub city manage their finances and leverage financial tools to achieve long-term growth and prosperity. Your insights will be invaluable in achieving this objective.

**Contact Address:** - Rahel Menbere

*E-mail:* rahelmodify@gmail.com

*Tele:* 0983839717

**Instructions**

- No need of writing your name and enterprise's name
- For Likert scale type statements and choice questions indicate your answers with a check mark (✓) ☐ in the appropriate block. Use ratings whereby; 1=Yes 2=No and 1=keep, 2=Don't keep

## **General Objective**

This study delves into the financial management practices of small and medium businesses (SMBs) operating within Addis Ketema sub city.

## **Specific Objectives**

- To examine the financial data organizing and reporting practices among SMEs.
- To evaluate the Financial planning practices by Addis Ketema SMEs with a particular focus on formal plans.
- To evaluate the methods used by SMEs to financial performance and ensure financial data.
- To assess the record-keeping practices employed by Addis Ketema SMEs to track their financial transactions.
- To evaluate the utilization of financial information by Addis Ketema SMEs in their decisions-making.

## **Questionnaires**

## Section1. Socio Demographic Information

1. Gender

1. Male ☐ 2. Female ☐

2. Age

1. 20-30 ☐ 2. 31- 40 ☐ 3. 41- 50 ☐ 4. Above 51 ☐

3. Education Level.

1. Diploma ☐ 2.Degree ☐ 3.Masters ☐ 4. Secondary school complete ☐

4. Department of study.

1. Accounting ☐ 2.Mangement ☐ 3. Marketing ☐ 4. Other ☐

## Section2. Organizational Information

5. Size of Business

1. Small ☐ 2. Medium ☐

6. How long has organization been in operation?

- 1.0-2 years ☐ 2. 2-4years ☐ 3.4-5years ☐ 4.Above 5 years ☐

7. Number of Employees.

- 1.1-5 ☐ 2.6-10 ☐ 3. 11-15 ☐ 4.Above 15 ☐

8. In What sector is your business categorized?

1. Manufacturing ☐ 2.Trade ☐ 3.Service ☐ 4. constriction ☐

9. Do you prepare Financial Statement?

1. Yes ☐ 2. No ☐

If “No” to question 9 above, what are the key factors that hinder you preparing those financial statements?

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If “yes” to question 9 above, how often do you prepare your financial statements?

1. Monthly ☐ 2.Quarterly ☐ 3.Annually ☐

10. What is the objective of Financial Statement?

1. To know current of financial states ☐  
2. To governmental Purpose ☐  
3. Other (please specify) ☐

11. How often do you reconcile your bank statements?

1. Monthly ☐ 2.Quarterly ☐ 3.Annually ☐ 4.Never ☐

12. How do you a system for storing and organizing your financial records?

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### Section3. Financial Planning Information

13. Do you have a written business plan that outlines your financial goals?

1. Yes ☐ 2.No ☐

If “No” to question 13 above, what are the key reason not prepare financial plan?

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14. How often do you review and update your financial goals?

1Monthly ☐ 2.Quarterly ☐ 3.Annually ☐ 4Never ☐

15. Which pricing strategy do you follow?

- 1. Pricing based experience ☐
- 2. Pricing based both competitors & market situation ☐
- 3. Pricing based experience, competitors & market situation ☐
- 4. No pricing strategy follow ☐

If “No pricing strategy follow” to question 15 above, how to manage?

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16. What is the use of pricing strategy follow?

- 1. Achievement of target profit. ☐
- 2. Achievement of target sales ☐
- 3. Achievement of market share ☐
- 4. Other ☐ (please specify)

17. How much the initial capital of the business? (In Birr)

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18. How much current capital of the business? (In Birr)

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19. How much annual sales of the business?(In Birr)

20. In Which categories your business annual profit?

1.0-50,000 ☐ 2.50, 000-100,000 ☐ 3.100, 000- 200,000 ☐ 4.Above 200,000 ☐

Likert scale

	Planning and analysis	Yes	No	
21.	The enterprise analyzes the trend of profit.			
22.	The enterprise analyzes the trend of sales.			
23.	The enterprise analyzes the trend of total asset.			
24.	The enterprise analyzes the trend of market share.			

25. How to achieve business plan?

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#### Section4. Financial control Information

	Control	Yes	No
26.	Do you regularly track your actual financial performance against your budget or goals?		
27.	Do you take corrective action when your actual results deviate significantly from your budget or goals?		

If Agree to question 26, please describe the types of corrective actions you take

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28. What tools or methods do you use to monitor your financial performance?

1. Accounting software ☐ 2.Spreadsheets ☐ 3. Manual records ☐ 4. Other ☐ (please specify)

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29. What are the most problems of financial control you enterprise?

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## Section5. Financial Recording Information

30. Does the enterprise maintain a formal system for recording financial transactions?

1. Yes ☐ 2.No ☐

If “No” to question 30 above, what are the key reason not prepare financial recording?

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		Likert scale	
	Recording	Keep	Don't Keep
1	Do you keep sales record/book?		
2	Do you keep purchase record/book?		
3	Do you keep purchase Expense /book?		
4	Do you keep provision for depreciation?		
5	The enterprise keeps its drawing?		
6	Do you keep fixed assets register?		
7	Do you keep stock record/book?		
8	Do you keep cash record/book?		
9	Do you keep receivables record/book?		
10	Do you keep payables record/books?		
11	The enterprise account its cash balances daily basis?		
12	The enterprise accounts its collection on regular basis?		
13	Do you have a clear understanding of the difference between cash flow and profit?		
14	The MSE purchase on credit?		

## Section6. Financial Decisions Information

31. Does the enterprise made evaluation of feasibility before starting the business?

1. Well studied ☐ 2. Somehow ☐ 3. Not at all ☐

What evaluation criteria do you use?

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32. What is the goal of your enterprise?

1. Profit maximization ☐  
2. Wealth maximization ☐  
3. Customer satisfaction ☐

33. Do you use financial information to make key business decisions like pricing, inventory management?

1. Yes ☐ 2.No ☐

34. Do you have a financial advisor or consultant who helps you manage your business finances?

1. Yes ☐ 2.No ☐

35. What are the biggest challenges you face in terms of making sound financial decisions for your business?

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Thank you your cooperation!