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APPLICATION OF FINANCIAL MANAGEMENT TECHNIQUES AND ITS IMPACT ON PERFORMANCE OF SMEs: EMPIRICAL EVIDENCE FROM JAFFNA DIVISIONAL SECRETARIAT

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ABSTRACT

Financial management techniques are fundamental to the effective operation and long-term viability of business organizations. When these techniques are applied appropriately, they assist firms in utilizing resources efficiently and in achieving their objectives in a sustainable manner. This survey strived to explore how financial management techniques influence the performance of small and medium-sized enterprises (SMEs) in the Jaffna region. The study intensive on Working Capital Management, Investment Appraisal, Capital Structure, and Financial Reporting as exogenous variables, with SME performance considered as the endogenous variable. Using a random sampling approach, data were collected from 105 SMEs operating in the Jaffna Divisional Secretariat (DS) Division as of 31st December 2023 through structured questionnaires. The gathered data were examined using multiple regression techniques with the aid of the Statistical Package for Social Sciences (SPSS).The outcomes specify that Working Capital Management and Capital Structure practices exert a positive and statistically significant influence on SME performance. In light of these findings, the study emphasizes the weight of strengthening financial management techniques among SMEs, specifically in relation to optimizing capital structure and enhancing working capital efficiency. An appropriate mix of financing sources can reduce the likelihood of financial distress by maintaining sufficient liquidity to support day-to-day operations. Additionally, sound capital structure decisions enable SMEs to secure funds for growth related activities such as business expansion, mergers and acquisitions, research and development, and other strategic investments. Overall, the outcomes provide fruitful insights for SME owners and managers to withstand existing business and secure long-lasting sustainability via the proper adoption of financial management techniques.

Key words: Capital Structure, Financial Reporting, Investment Appraisal, SME's performance. Working capital management

1. INTRODUCTION

Small and medium-sized enterprises (SMEs) play a prominent role in the development of national economy by contributing significantly to financial sustainability and job creation. The World Bank states that plenty of job opportunities in emerging markets are brought out by SMEs (World Bank, 2020). An increasing body of research also provides evidence that the growth and development of SMEs are critical to overall economic development. In accordance to the statistics published by Department of Census and Statistics, Sri Lanka, the Economic Census 2013/2014 reported that there were approximately 1.017 million SMEs in the country, providing about 2.25 million employment opportunities (Department of Census and Statistics [DCS], 2015). Based on more recent statistics, SMEs in Sri Lanka contributed approximately 45% of Gross Domestic Product (GDP) and 52% of total employment in 2022 (DCS, 2023). Despite their economic significance, many entrepreneurs do not actively engage in financial-related matters due to insufficient knowledge or lack of

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interest, as they are heavily involved in other aspects of business operations (Wanjiku, 2015). In such situations, owners tend to rely on the expertise of accountants for financial decision-making. Furthermore, inadequate knowledge of financial management practices, coupled with uncertainty and challenges in the commercial environment, has led to serious organizational performance issues among SMEs (Karadag,2015). Reports of the Jaffna Industrial Development Board indicate a notable raise in the number of registered SMEs in Jaffna during the past year. However, several studies have found that many SMEs fail due to uncertainties, changing market needs, weak operational capacity, and poor financial management practices (Balagobei,2019). The World Bank also highlights that limited availability of finance is a biggest obstacle withstood by SMEs in emerging and developing economies, significantly hindering their growth potential (World Bank, 2020). The Central Bank of Sri Lanka (2018) identified several key challenges confronting the Sri Lankan SME sector, including inadequate capital, outdated technology, and poor accounting practices, and managerial inattentiveness, all of which contribute to financial management problems that adversely affect business performance. Consequently, financial management is recognized as one of the most critical managerial skills required for SMEs (Yogendrarajah et al., 2017). Many entrepreneurs pursue business ideas without adequate knowledge of market dynamics, consumer behavior, or financial management practices. This lack of knowledge leads to difficulties in obtaining finance, managing resources efficiently, and adopting appropriate technologies, thereby significantly affecting long-term business sustainability.

Sooriyakumar et al. (2022) reported that exorbitant debts arising from loans provided by microfinance institutions to failing businesses have contributed to at least 170 deaths by suicide island-wide within a single year, with the highest rates reported among women, particularly in the Vavuniya, Jaffna, and Batticaloa districts. According to Udayan newspaper (2024, February 14), the impact of microfinance has been substantial, affecting nearly 2.8 million individuals across the country. Notably, out of this population, approximately 2.4 million are women entrepreneurs. These entrepreneurs have been subjected to extremely high interest rates ranging from 38% to 48%, creating severe difficulties in repaying loans, despite the relatively small amounts borrowed. This situation highlights the deep-rooted financial challenges faced by small-scale entrepreneurs. Effective financial management enables businesses to achieve their organizational goals by supporting informed decision-making and ensuring long-term sustainability. Accordingly, this research inspects the influence of FM techniques on the performance of small and medium enterprises (SMEs) in Jaffna. The exogenous variables considered in this study include working capital management, investment appraisal, capital structure management, and financial reporting. The aim of this research is to identify the financial management (FM) practices adopted by SMEs and to analyze how these practices influence their performance. To achieve the research objectives, a survey was conducted among SMEs operating within the Jaffna Divisional Secretariat Division. There is a significant responsibility to highlight the inevitable adoption of FM practices among SMEs in the northern region, as they may face financial challenges. By conducting this research, SMEs in the Northern Province can better understand the importance of FM practices and their influence on business success. Furthermore, the findings will help SME owners identify the causes of business failure and adopt appropriate strategies to overcome these challenges.

2. LITERATURE REVIEW

Due to the ongoing crisis faced by Sri Lanka, research should prioritize activities aimed at addressing the challenges encountered by small and medium-sized enterprises (SMEs) (Sooriyakumar et al.2022). SMEs play a significant role in economic growth, employment generation, and overall economic stability; therefore, strengthening their resilience is essential for the country's recovery and sustainable development. Financial management is an operational activity of a business that focuses on obtaining and effectively utilizing funds necessary for efficient operations and is directly associated with top-level management (Tharmini & Lakshan, 2021). The capacity of small and medium enterprises to effectively access and manage financial resources

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determines their ability to expand, enhance, retain, and strengthen their business operations (Balagobei, 2019). Financially well-managed firms tend to be more operationally efficient (Rathirani et al., 2017; Sooriyakumar et al., 2022). Conversely, disorganization in financial management leads to weak business performance and may ultimately cause setbacks for SMEs (Somathilake & Pathirawasam, 2015).

2.1 Empirical findings on Working capital Practices and SME's performance:

Working capital management (WCM) is essential for the continuity and development of small and medium enterprises (SMEs) (Sensini, 2020). By maintaining an optimal level of working capital and implementing sound WCM practices, businesses can achieve greater financial stability, enhance profitability, and strengthen their competitive advantage. Conversely, mismanagement of working capital can lead to financial distress, even among otherwise profitable firms. Working capital refers to the financing required by an organization to carry out its day-to-day operational activities (Sooriyakumaran et al., 2022). Therefore, SMEs should maintain liquidity position properly to continue their business without any disturbances, this will help them for the payment of expenses on time, bulk purchasing of materials and to maintain good reputation of the business. Previous empirical studies have revealed that WCM has a positive impact on firm performance (Lazaridis & Tryfonidis, 2006; García-Teruel & Martínez-Solano, 2007; Ramachandran & Janakiraman, 2009; Butt et al., 2010; Niazi et al., 2011; Jennifer & Dennis, 2015; Dalayeen, 2017; Nthenge & Ringera, 2017; Arshad et al., 2021; Lefebvre, 2022).

In contrast, Parrino et al. (2000) and Somasinghe et al. (2017) identified a strong relationship betwixt WCM and profitability, liquidity, and overall financial health. Rahman et al. (2015) demonstrated that effective WCM enhances operating profits, while Nyamao et al. (2012) emphasized its importance, particularly in challenging business environments. Furthermore, Wanjiku (2013) and Nyakundi et al. (2016) observed that efficient management of cash, inventory, and receivables significantly improves SME performance. Padachi (2006) and Kosgey and Njiru (2016) also found a positive relationship betwixt WCM and financial performance. However, Fasesin et al. (2017) reported that inventory and trade credit management exert only a limited effect on firm performance. Additionally, Forghani et al. (2013) and Azam and Haider (2011) confirmed that WCM significantly influences returns on equity and assets, while Nastiti et al. (2019) emphasized that effective WCM drives both profitability and sustainable business growth.

2.2 Investment Appraisal and SME's performance

Investment is a perilous factor in any organization; however, poor investment decisions can negatively affect business performance. To ensure optimal allocation of resources, organizations use capital budgeting to identify and select the most viable investment opportunities. Capital budgeting involves evaluating alternative projects and choosing those expected to generate the highest value for the firm. Wambua and Koori (2018) found that capital budgeting methods such as the payback period, net present value, and internal rate of return significantly effect on SME performance in Kenya, with the period of payback being the most commonly useful and impactful technique. Likewise, Mushaho et al. (2015) stated a positive impact of capital budgeting practices on organizational performance. In contrast, Kengatharan et al. (2017) and Karanja (2012) found no significant association betwixt investment decisions and performance of SMEs. Nonetheless, Butt et al. (2010) and Daniel and Japhet (2017) underlined the critical role of investment decisions in shaping SME success. Collectively, these studies underscore the importance of effective investment decision-making in enhancing business performance.

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2.3 Capital Structure practices and SME's performance

Capital structure refers to the mix of different financing sources employed by a firm and reflects the financial decisions made by its management. It is a key determinant of a firm's financial stability and long-term growth, making it a critical consideration for all organizations. Empirical studies by Ahmad et al. (2012) and Sandaruwandi et al. (2024) suggest that effective management of capital structure can notably increase SME performance. However, other studies have reported contrasting findings. For instance, Mwangi et al. (2014) found a significant negative association betwixt capital structure and performance of the firm. Alike, Karanja (2014) demonstrated that the Equity ratio notably shakes the performance of dairy SMEs, while Sandaruwandi et al. (2024) noted that capital structure has a adverse effect on profitability but contributes positively to liquidity and sales growth.

2.4 Financial Reports and Analysis and SME's performance

Financial reports form the backbone of financial-related activities such as financial planning, analysis, benchmarking, and decision-making. Previous studies by Sooriyakumaran et al. (2022) revealed noteworthy association betwixt financial reporting practices and business performance. However, Yogendrarajah et al. (2017), in their study on financial management practices and performance of SME in Sri Lanka, postulated that business reporting and analysis do not have a major effect on the performance of SMEs. Many SMEs, particularly in Sri Lanka, rely on casual accounting systems and lack comprehensive business reports, which poses a major challenge in uncertain business environments. Several studies indicate that many SMEs fail to maintain proper financial records, often perceiving them as unnecessary or overly revealing this inadequacy in record-keeping negatively affects managerial decision-making and overall business performance (Muneer, 2017).

Similar studies were conducted in the Jaffna region prior to 2020. However, following the COVID-19 pandemic, the Sri Lankan economy has experienced a severe financial crisis. Findings from previous research indicate that the victory of SMEs has a noteworthy effect on overall economic growth. Conducting such studies more frequently can help raise awareness among SMEs about strategies and practices that can be adopted to overcome challenges arising during periods of economic crisis. Based on the above facts and empirical evidence, the present study formulates the following hypotheses

H_1: Application of Financial Management techniques significantly impact on SME's performance.

3. RESEARCH MRTHODS

3.1 Study population and Sample

Study population comprises 1,086 SMEs registered in the GS Division in 2022. From this population, a sample of 150 SMEs was chosen using a random sampling technique for the survey.

3.2 Response ratio

Sample size of the survey was 105 SMEs operate in Jaffna DS division for the duration 2023. 150 questionnaires were issued SMEs located in Jaffna DS division. However, due to the non-responsiveness and incompleteness 16 and 29 questionnaires were excluded respectively from the analysis. Therefore, the sample for the study was adjusted to 105. Hence, 70% of response rate was noted for this survey.

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3.3 Collection of Data

The necessary data for the current survey were garnered from the primary bases using well-structured questionnaire. There are three parts in this questionnaire. The Part I of this questionnaire deals with the personal or demographic aspects of the SMES and it consists of 7 questions. The Part II of this questionnaire comprised of questions related to financial Management Practices. Finally, the Part III of the questionnaire carries questions regarding SMEs performance and respondents were asked to select one of the choices ranging from mostly agreed (5) to mostly disagreed (1) from five-point Likert scale of agreement.

3.4 Conceptual Model

Drawing from the relevant review of literature, the researcher developed the subsequent theoretical framework. As stated by the diagram FM techniques and SMEs' performance are taken as exogenous and endogenous variable respectively.

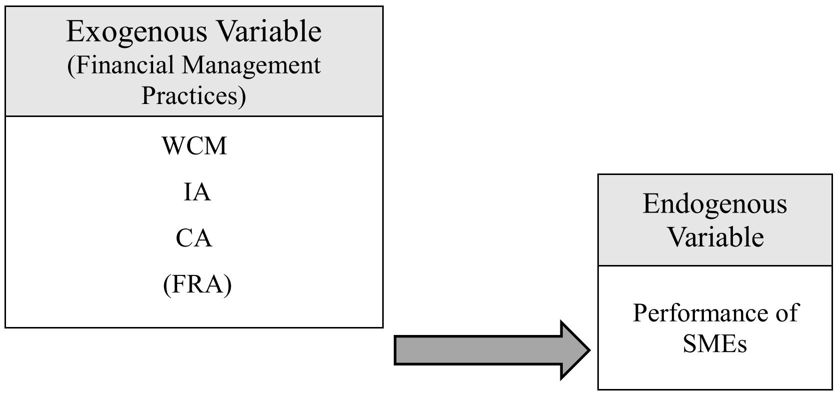

Figure 1:
Conceptual Framework
Source: Developed by Researcher

3.5 Statistical Model

This survey employs a multiple linear regression approach to assess the effect of FM techniques on the performance of SMEs in the Jaffna region. The general form of the regression equation is expressed as: $Y=\beta_0+\beta_1X+\varepsilon$. By incorporating the specified Endogenous Variable and Exogenous Variable into this equation, the empirical regression model for the study is derived accordingly:

Performance of SME = β0 + β1WCM + β2IA + β3CSM + β4FRA + e -Model 1

4. ANALYSIS OF FINDINGS

4.1 Demographic Characteristics and Business Profile of Respondents

The survey was conducted among the SMEs of Jaffna peninsula in the Northern Province of Sri Lanka. This section aims to present the demographic Characteristics and Business Profile of Respondents of gender, , age, relationship, education, occupational qualification, Number of years of operation, Number of employees and annual Income. Table 1 Presents Demographic Characteristics and Business Profile of Respondents.

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Table: 1 Summary of Demographic and Business Profile of Respondents

Variables	Classification	Responses	Percentage
Gender category	men	55	52%
	Women	50	48%
Respondent Age	18 to 25 years	18	17%
	26 to 35 years	13	12%
	36 to 50 years	24	23%
	above 50	50	48%
Relationship	Single	35	33%
	Married	52	50%
	widow	10	10%
	Divorce	8	8%
Educational Qualification	O/L	31	30%
	A/L	30	29%
	Diploma	29	28%
	Degree	15	14%
Duration of Operation	Less than 6 years	49	47%
	6–10 years	17	16%
	11–15 years	13	12%
	More than 15 years	26	25%
Number of employees	0 -10	87	83%
	11 - 50	11	10%
	51 - 150	7	7%
	Above 150	0	0%
Annual income	Below 1 million	43	41%
	1,000,000 – 1,500,000	41	39%
	1,500,001 – 3,000,000	18	17%
	Above 3,000,000	3	3%

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With the purpose of carrying out this survey, the data has been collected from 105 small and medium enterprises in Jaffna DS division, Sri Lanka. The Table 1 demonstrated that 52% of enterprise's owners were male and females were 48% which is almost equal, thus showing there is no gender dominance in the ownership. Majority of respondents (48%) were above 50 years old. Most common marital status among respondent were married (50%), while single (33%), widow (10%), divorcee (8%) was the reasonable amount. Researcher can conclude that SME sector is characterized by unstable or unconventional family structures. Primary education (30%), Advanced Level (29%), Diploma (28%) were the most common education qualification. Only, 14% degree holders involved in SMEs. Researcher can conclude that well educated people choose white color job instead of take risk. Only 14% of respondent were professionally educated. Therefore can be concluded the majority of respondents who have low education background are involved with SMEs. When considering the years of operations majority (47%) of SMEs were in their startup stage. This may suggest that the SME sector is dynamic and entrepreneurial, with a high entry and exit rate. Almost 83% of SMEs run their operations with 0-10 employees. Only 3% of SMEs earn above 3 million annually while rest of the respondents earn below 3 million.

4.2. Reliability Statistics

Table 1: Cronbach's Alpha Analysis

Construct dimensions	Cronbach coefficient Alpha	Items included
WCM	0.64	8
IA	0.87	11
CS	0.85	9
FRA	0.84	8
SME'.s Performance	0.87	4

Cronbach's Alpha Analysis was engaged to measure the internal reliability of the study variables. Generally, Values of Cronbach's alpha between 0.6 and 0.7 are regarded as satisfactory, while a high level of internal consistency is indicated by values of 0.8 or above. In this study, the Cronbach's alpha values for all exogenous and endogenous variable beat 0.6, confirming that the 40 measurement items are reliable and demonstrate satisfactory internal consistency.

4.3 Summary Statistics

Table 2: Summary Statistics

	Mean	St. Dev.
WCM	3.7810	1.17654
IA	3.2667	1.35637
CS	3.4000	1.34879
FRA	2.3381	1.34539
SME's Performance	3.0476	1.50883

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The study revealed that the majority of respondents adopted WC more rigorously than other financial management practices, with a mean value of 3.7810. This was followed by IA and FRA , which recorded mean values of 3.2667 and 2.3381, respectively. Specifically, studies by Turyahebwa (2013) and Tharmini and Lakshan (2021) similarly observed that WCM achieved the highest mean score among various financial management practices.

4.4 Results of Correlation Analysis

The present study used the coefficient of Pearson's correlation to assess the strength of the association betwixt the Endogenous Variable and Exogenous Variable. It is shown in Table 4.

Table 3: Correlation Analysis

		WCM	IA	CSM	FRA	P
WCM	Pea. Correlat.	1				
	Signi. (2-tail.)					
IA	Pea. Correlat	.466**	1			
	Signi. (2- tail.))	0.000				
CSM	Pea. Correlat	.474**	.357**	1		
	Signi.. (2 tail.))	0.000	0.000			
FRA	Pea. Correlat	.265**	.344**	.240*	1	
	Signi. (2- tail.)	0.006	0.000	0.014		
Performance of SME's	Pea. Correlat	0.093**	0.121	.364**	.222	1
	Signi. (2- tail.)	0.004	0.220	0.000	0.123	
	N	105	105	105	105	105

The correlation matrix presented above indicates the coefficients value of correlation and probability values betwixt the Endogenous Variable and Exogenous Variable. As shown in Table 4, WCM ($r = 0.093$, $p < 0.05$) and CSM ($r = 0.364$, $p < 0.05$) have a positive and significant relationship with SME performance. These results indicate that effective application of techniques regarding working capital management practices and a sound capital structure contribute to improved performance of SME's. This results line with earlier studies, which demonstrate the significant role of capital structure management in influencing SME performance (Yogendrarajah et al., 2017; Somathilake & Pathirawasam 2020). Similarly, previous research has highlighted that working capital management practices play a critical role in enhancing SME performance (Musah et al., 2018; & Balagobei, 2019).

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4.5 Statistical results of the regression model

Regression analysis is a broadly used tool of data analysis and it leads to simple, but, powerful descriptions of the main characteristics of the relationships among variables. Regression specifies the cause and effect relationship between the variables. With the intension of examining the impact of application of FM techniques on SMEs performance multiple regression analysis has been carried out. The following table (Table 5) presents the model summary of the analysis.

Table 5: Regression Analysis Model Summary

Model	R	R Square	Adjusted R Square	Durbin-Watson
1	.693	.481	.479	1.915

The regression model summary indicates a strong positive relationship between the Exogenous Variable and Endogenous Variable (SME's performance), with an R value of 0.693. The R^2 value of 0.481 suggests that approximately 48.1% of the variation in SME performance is described by the predictors comprised in the model, while the adjusted R squared of 0.479 confirms a good model fit after accounting for the number of variables. The Durbin-Watson statistic of 1.915, being close to 2, shows that there is no noteworthy autocorrelation in the residuals, suggesting that the independence assumption for regression analysis is met. Overall, these results show that the model provides a reasonably strong explanation of SME performance based on the selected financial management practices.

Table 6: Summary of F statistics

Model		Mea. Squa.	F Value	Signifi
	Regress.	79.114	333.840	.000[b]
1	Resid.	.237		
	Total value			

The F statistics of the model is 333.3840 which is significant since $p < 0.05$.It indicates that this regression model have the ability to explain the variance of the Endogenous Variable. The impact of FM techniques on Performance of SME's in the Jaffna can be examined by using the coefficient values and t statistics. And relevant p values are shown in the Table 7.

Table 7: Regression Analysis: The Impact of application FM techniques on Performance of SME's

	B	t	Sig.	VIF
(Constant)	1.571	2.815	0.006	
WC practices	0.189	1.707	0.009	1.21
IA practices	-0.019	-0.154	0.878	1.36
CSM Practices	0.437	3.693	0.000	1.72
FRA practices	0.143	0.249	0.166	1.81

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Dependent Variable: SMEs Performance

The results of regression show that the constant term is significant (Beta = 1.571, t= 2.815, $p<0.05$), indicating that there is a positive baseline value of the performance of SMEs even when other variables are zero. As per the results of regression Working capital management practices (Beta = 0.189, $p < 0.05$) and Capital structure practices (Beta = 0.437, $p<0.05$), have positive and significant impact on performance of SMEs. This implies that when the SMEs apply the techniques of working capital and capital structure, performance of their business will be improved. This conclusion is reliable with earlier study of Turyahebwa, et al, (2013), McMahon and Adelaide (1999), Tharmini and Lakshan (2021), which revealed that financial management practices have positive and significant impact on performance of SMEs. VIF statistics for whole factors are less than 10. It specifies the nonexistence of multicollinearity problem and the model is acceptable. Furthermore, the value of Durbin Watson is 1.915 and thus the model has no autocorrelation among residuals. This finding consistent with the study of Durbin Watson test was carried out to check the autocorrelation or serial correlation. The F value of 4.957 was obtained.

5. CONCLUSION & RECOMMENDATIONS

This survey is intensive on investigating the application of FM techniques on performance of SMEs of Jaffna Divisional Secretariat. According to multiple regression analysis, WCM and CSM practices have positive and significant impact on performance of SMEs. Findings of Yogendrarajah et al, (2017), Muneer et al (2017), Nguyen et al (2021) and Sandaruwandi et.al. (2024) also supported to the findings that CS practices and WCM techniques have significant impact on performance of SMEs. They suggested that Well-structured capital mix will help to alleviate the risk of financial pain and insolvency by ensure that SMEs have adequate amount of money to meet its operational needs. It also provides the necessary resources for expansion, acquisitions, research and development, and other strategic initiatives. Furthermore, SMEs can run their business without any disturbance when they properly implement working capital management through implementing the techniques such as Economic Order Quantity, maintain inventory level, preparing cash budget to determine the minimum cash balance. Even though there is a noteworthy influence on performance, most of the SMEs does not involve themself to prepare financial statement. Maintaining financial reporting helps to reduce the tax burden of SMEs and ensure that SMEs resources are not depleted in a short amount of time. Finding of this study will help to the SMEs to provide awareness regarding the benefits of application of FM techniques for the success of the business.

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