

**FINANCIAL MANAGEMENT PRACTICES:  
AN INDEPTH STUDY AMONG THE CEO OF SMALL AND MEDIUM  
ENTERPRISE (SMEs)**

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**ABSTRACT**

The important contribution of small and medium-scaled enterprises in Malaysia's GDP, employment, and industrialization has been well documented. Although their role in the economy is substantial, many SMEs are plaque by management problems (Hashim and Wafa, 2002). These management problems include human resource management, marketing management, operations management, financial management, and strategic management. Given that financial management is one of the key aspects of the well being and survival of a business, it is important that this topic is explored in depth.

Thus, the main purpose of the present study is to investigate the financial management components and techniques practiced by the SMEs in Malaysia.

The study comprises of two analyses, that is, in the first analysis, six financial management components were identified, namely financial planning and control, financial accounting, financial analysis, management accounting, capital budgeting, and working capital management. Subsequently, in the second analysis, various financial management techniques were identified under each component stated earlier.

Data for the study is obtained by conducting a face-to-face interview using structured questionnaire with respondents from selected SMEs. The study sample comprised of 30 SMEs operating in the Kota Setar and Kubang Pasu district of Kedah Darul Aman.

The findings of the study show that three components of financial management to be categorized as core components practiced by the SMEs, that is, financial planning and control, financial accounting, and working capital management. Three other components which are financial analysis, management accounting, and capital budgeting can be categorized as supplementary components practiced by the SMEs due to the small percentage of the SMEs using these components in the management of their business.

## Introduction

Small and Medium-scaled Enterprises (SMEs) in Malaysia have been identified as an important contributor to the economy (Hashim, 2005). Their contributions can be assessed in terms of their numbers, economic output, employment opportunities provided, and assisting large companies (Hashim, 2005).

According to the Census of Establishments and Enterprises 2005, there are a total of 523,132 establishments in the manufacturing, agriculture and services sectors in Malaysia. They make up a total of 39,219 (7.3%) enterprises in the manufacturing sector, 451,515 (86.9%) in services, and 32,397 (5.8%) in the agricultural sector. More importantly, SMEs make up a significant proportion of these establishments. The current status of the SMEs in Malaysia can be seen in Table 1.1 below.

**Table 1: Current status of SMEs in Malaysia**

|                            | <b>Establishments</b> | <b>SMEs</b>    | <b>% of SMEs</b> | <b>% of structure</b> |
|----------------------------|-----------------------|----------------|------------------|-----------------------|
| <b>Total manufacturing</b> | <b>39,219</b>         | <b>37,866</b>  | <b>96.6</b>      | <b>7.3</b>            |
|                            |                       |                |                  |                       |
| Services                   | 119,980               | 118,662        | 98.9             | 23.0                  |
| Retail / Wholesale         | 312,245               | 311,234        | 99.7             | 60.2                  |
| Finance                    | 19,291                | 19,108         | 99.1             | 3.7                   |
| <b>Total services</b>      | <b>451,516</b>        | <b>449,004</b> | <b>99.4</b>      | <b>86.9</b>           |
|                            |                       |                |                  |                       |
| <b>Agriculture</b>         | <b>32,397</b>         | <b>29,985</b>  | <b>92.6</b>      | <b>5.8</b>            |
|                            |                       |                |                  |                       |
| <b>Overall total</b>       | <b>523,132</b>        | <b>516,855</b> | <b>98.8</b>      | <b>100</b>            |

*Source: Census of Establishments and Enterprises, 2005 (preliminary data), Department of Statistics*

Table 1.1 indicates that overall SMEs account for 98.8% or 516,855 of all enterprises enumerated. In the services sector, SMEs make up 99.4% or 449,004 of all service enterprises whereas in manufacturing they account for 96.6% or 37,865 establishments. SMEs account for 92.6% or 29,985 out of the 32,397 enterprises engaged in agriculture related activities.

In the year 2000, SMEs contributed about 22.2 percent of the total economic output and accounted for 17.9 percent of the total employment opportunities in the manufacturing sector (Hashim and Wafa, 2002). Last but not least, large firms need SMEs as suppliers, providers of customer service, and retailers of big business products. For instance, more and more small firms in Malaysia are acting as specialist suppliers to large firms as evidenced by the Vendor Development Program established by the Government (Hashim and Wafa, 2002).

A study conducted by Bank Negara Malaysia in 2003 on the SMEs identified prudent financial management as one of the key success factors for SMEs (BERNAMA, 2006). Unfortunately, many SMEs in Malaysia tend to neglect the importance of financial management in their businesses (BERNAMA, 2006). A study by Fong (1990) found that most SMEs in Malaysia were managed by the owners themselves. Therefore, the quality of management depends on the education, experience, and training of the entrepreneurs themselves. However, since many of them did not have a formal education in business management, they usually operated their business as traditional family-type businesses. Fong (1990) concluded that for the sector to remain dynamic, SMEs must employ professional managers for the continued growth of the firm. A professional financial manager will be able to manage the firm's financial affair so as to maximize the value of the firm for its owners.

### **Background of the study**

There exists a vast literature on financial management practices of firms. Among these are financial management of small and medium-sized firms (for example Cooley, 1979; Filbeck, 2000; Khoury, 1999; Thomas and Evanson, 1987). Studies done in the U.K. and the U.S. have shown that weak financial management – particularly poor working capital management and inadequate long-term financing – is a primary cause of failure among small business (Atrill, 2001). Moreover, the findings of the studies by Broom and Lengenecker (1975), Haswell and Holmes (1989), Bates and Nucci (1989), and Watson and Everett (1996) have shown that business failures were more prevalent among small businesses than larger firms.

In Malaysia, studies on financial management practices of SMEs are very scarce. Among the studies which explore the weaknesses in management areas of SMEs is by Hashim (2000) and Hashim and Wafa (2002). In the study, 100 SMEs in the manufacturing sector in Malaysia were surveyed. The findings identified 193 weaknesses in the areas of management within the SMEs as shown in Table 1.2.

**Table 2: Weaknesses of areas of management in SMEs**

| <b>No</b> | <b>Management functional areas</b> | <b>Frequency</b> | <b>Percent</b> |
|-----------|------------------------------------|------------------|----------------|
| 1.        | Human resource management          | 69               | 35.8           |
| 2.        | Marketing                          | 43               | 22.3           |
| 3.        | Operations / Production            | 37               | 19.2           |
| 4.        | Finance                            | 31               | 16.1           |
| 5.        | Strategic management               | 11               | 5.6            |
| 6.        | General management                 | 2                | 1.0            |
|           | <b>Total</b>                       | <b>193</b>       | <b>100.0</b>   |

*Source: Hashim and Wafa (2002)*

Table 2 shows that out of the total of 193 weaknesses, 16.1 percent are in the area of finance, which is in fourth position after human resource management (35.8 percent), marketing (22.3 percent), and operations/production (19.2 percent). Specific areas of weaknesses within financial management are shown in table 3.

**Table 3: Weaknesses in financial management**

| <b>Finance</b>                              | <b>Frequency</b> | <b>Percent</b> |
|---|------------------|----------------|
| Lack of working capital                     | 29               | 93.6           |
| Difficult to get credit for raw materials   | 1                | 3.2            |
| Lack of support from financial institutions | 1                | 3.2            |
| <b>Total</b>                                | <b>31</b>        | <b>100.0</b>   |

*Source: Hashim and Wafa (2002)*

Table 3 shows that lack of working capital is found to be the most common weakness in the area of financial management where it accounted for 93.6 percent of the total weaknesses in the area of financial management. However, the study did not elaborate more on the areas of weaknesses in financial management beyond working capital.

A subsequent critical review of the literature on financial management practices of SMEs in Malaysia reveals that more in-depth examination of financial management weaknesses is needed since financial management involves more components than working capital alone. A survey of the literature shows six components of financial management, namely, financial planning and control, financial accounting, financial analysis, financial accounting, capital budgeting, and working capital management. Therefore, this study aims to *examine each of these components in detail to determine the components being practiced by the SMEs in Malaysia.*

### **Justifications of the study**

This study was conducted to identify financial management techniques used by the SMEs. This study was also carried out on the bases of growth of SMEs in Malaysia, government-supported funds, and gaps in the literature. These justifications are explained next.

**The growth of the SMEs in Malaysia.** Historically, the foundation for growth of small and medium-scaled enterprises in Malaysia was in the traditional sector – agriculture related and cottage industry activities (Hashim, 2002). But now SMEs exist in almost all sectors of the Malaysian economy. However, more recently, due to political and economic changes, SME business activities have expanded rapidly and become an important component in the manufacturing sector (Hashim, 2005). This is demonstrated by the output of the SMEs, worth RM4.3 billion or 20 percent of the Gross Domestic Product (GDP) in 1990. Their output is further projected to be worth RM120 billion or 50 percent of the GDP by the year 2020 (New Straits Times, 1994).

**Government supported funds.** The SME importance is reflected in the fact that there are more than 18 ministries and more than 60 government agencies involved in assisting the development of the SME sector in Malaysia (Hashim, 2000). These assistances can be grouped into financial assistance, project development, advisory services, and technical assistance (Fong, 1990).

As for financial assistance, there are various financial packages for SMEs that can be tapped for projects and working capital financing. Among them are a revolving fund managed by SMIDEC and Bank Industri Malaysia, the Modernization and Automation Scheme for SMEs implemented by the Malaysian Industrial Development Finance Berhad, the Soft Loan Scheme for Quality Enhancement of SMEs implemented by Bank Pembangunan Malaysia Berhad, and a stimulus package announced in 2003 allocated to Bank Pertanian Malaysia and Bank



Simpanan Nasional to carry out their micro-credit schemes. Furthermore, SME Special Unit at Bank Negara Malaysia was launched on May 20<sup>th</sup> 2003 to assist SMEs on information about the various sources of financing, facilitate loan-application process, and provide advisory services other financial requirements.

Under the Malaysia Development Plan (Five Year Plan), the government had allocated RM133.8 million and RM500 million in the Sixth Malaysia Plan and the Seventh Malaysia Plan, respectively for SME financing. In addition, the Small and Medium Industries Development Corporation (SMIDEC) was allocated RM221.4 million for SME development program under the Eighth Malaysia Plan (2001 – 2005).

As can be seen, much government resources are channeled into programs for SMEs to further develop the sector. Therefore, it is of vital concern that these resources are managed efficiently and effectively for these resources to achieve its policy objective. Consequently, it is important that a study is done on the financial management techniques practiced by the SMEs to facilitate our understanding of the implications of the results for policy makers.

**Gaps in the literature.** A search of the literature on SMEs in Malaysia reveals a gap in the area of financial management practice among SMEs in Malaysia. One of the most comprehensive studies of SMEs was done by Fong (1990). The focus of his study was to examine the profile, the existence of economic linkages between large and small firms, and the economic role of the SMIs to revitalize the economy. In general, the emphasis of the studies on SMEs in Malaysia have concentrated on observing and reporting the characteristics or profiles of the SMEs (Chee, 1986; Ling, 1990; Lisa, 1990), on the problems and constraints faced by the SMEs (Hashim, 1999; Chee, 1986), on the SME assistance program provided by the government (Chee, 1986; Hashim, 2000), and on the SME managerial practices (Hashim, 2005).

However, to the best of our knowledge, there has not been any study specifically on the topic of financial management of the SMEs. Therefore, this study, which intends to investigate the usage of financial management techniques among the SMEs in Malaysia, will enrich the empirical literature of financial management practices of SMEs.

## **Literature Review**

### **Definition of small and medium-scaled enterprises**

Since we are interested in knowing the financial management techniques practiced by the SMEs, naturally we begin with a discussion on the components of financial management practiced by the SMEs. At the outset, it is important for us to define what constitutes an SME and to compare the definition of SMEs adopted in Malaysia with those in other countries.

**Definition of SMEs in other countries.** The definitions of SMEs are provided by various countries and the International Bank for Reconstruction and Development (World Bank). Some examples of SME definitions by the Asia Pacific Economic Cooperation countries are shown in table 4. As the table illustrates, there is significant variations in the definitions. The number of employees is the most common measure, though many definitions also use a monetary measure (such as capitalization, or sales). Even with the number of employees there is considerable diversity; in most economies an SME is defined as having less than 100 employees (and even fewer in specific industries such as services or retail), but in some larger economies this ceiling is raised to 300 or even 500 employees.

Therefore, what constitutes an SME seems to depend on the definition adopted. It is clear that different countries use different standards and different criteria to

measure the size of firms. Therefore, it can be concluded that there has been no universally accepted definition of what a SME is (Hashim, 2005). However, we must realize that the distinction between micro, small, medium, or large is somewhat arbitrary. Therefore the real issue when we try to make comparisons across countries is that we are comparing equals with equals (APEC, 2000). Making comparisons thus requires comparable size classes. Unfortunately the size classes used differ across economies. Therefore, we must be cautious when comparing SMEs across countries.

**Definition of SMEs in Malaysia.** The definitions of SMEs by various government agencies and organizations in Malaysia show considerable differences as well. Table 5 and 6 below illustrates the definitions of SMEs provided by various government agencies in Malaysia.

**Table 4: SME definitions in selected Asia Pacific Economic Cooperation (APEC) member countries**

|                                       | A              |                | B                           |                   | C                                 |                   |
|---------------------------------------|----------------|----------------|-----------------------------|-------------------|-----------------------------------|-------------------|
|                                       | Employees      |                | Total assets<br>(RM000,000) |                   | Total annual sales<br>(RM000,000) |                   |
|                                       | Small          | Medium         | Small                       | Medium            | Small                             | Medium            |
| Australia                             | < 20           | 20 – 200       |                             |                   |                                   |                   |
| Brunei                                | 6 - 50         | 51 – 100       |                             |                   |                                   |                   |
| Canada                                | 50 - 100       | 51 – 500       |                             |                   |                                   |                   |
| Chile                                 | 5 - 49         | 50 – 199       |                             |                   | < 2.671                           | < 5.160           |
| Indonesia                             | 5 - 19         | 20 – 99        | < 0.688                     | < 3.440           | < 0.344                           | < 17.200          |
| Korea                                 | 10 - 50        | 11 – 300       |                             |                   |                                   |                   |
| Mexico                                | 31 - 100       | 101 – 500      |                             |                   |                                   |                   |
| Philippines                           | < 99           | 100 – 199      |                             |                   |                                   |                   |
| Russian                               | 10 - 99        | 100 – 500      |                             |                   |                                   |                   |
| Singapore                             |                | < 200          |                             | < 34.017          |                                   |                   |
| Thailand                              | < 50           | 50 – 200       | < 2.305                     | < 11.524          |                                   |                   |
| USA                                   |                | < 500          |                             |                   |                                   | < 17.200          |
| Vietnam                               | < 30           | 31 – 200       |                             |                   |                                   |                   |
| <b>Average used<br/>in this study</b> | <b>&lt; 50</b> | <b>&lt;250</b> | <b>&lt; 3.00</b>            | <b>&lt; 15.00</b> | <b>&lt; 3.00</b>                  | <b>&lt; 20.00</b> |

*Sources: Profile of SMEs and SME issues in APEC 1990 – 2000*

*([www.apec.org/apec/publications/all\\_publications/small\\_medium\\_enterprise.html](http://www.apec.org/apec/publications/all_publications/small_medium_enterprise.html))*

*Source: developed for this study*

Thus, the synthesis of the above definitions, this study proposed to design a new definition from SMEs to be used in this study, as shown in table 7.

**Table 5: Definitions of SMEs in Malaysia**

| <b>Criteria</b>             | <b>APEC definition</b>               | <b>CCDSI</b>             | <b>BNM</b>  | <b>MITI</b>                                       | <b>SMIDEC (Prior To June 9, 2005)</b>             | <b>Definition of SME for this study</b> |
|-----------------------------|--------------------------------------|--------------------------|---|---|---|---|
| No. of employee (full time) | < 50 (Small)<br>< 250 (Medium)       |                          |   | <50 (Small),<br>51 – 150 (Medium)                 | <50 (small),<br>51 – 75 (Medium)                  | <50(Small)<br><150(Med)                 |
| Annual sales turnover       | RM< 3 m (Small)<br>RM< 20 m (Medium) |                          |   | <RM10 million (Small),<br>RM10m – RM2.5m (Medium) |   | RM<10m (Small)<br>RM<25m (Medium)       |
| Fixed asset                 | RM< 3 m (Small)<br>RM<15m (Medium)   | <RM250,000 (Enterprises) |   |   |   |   |
| Shareholders' fund          |                                      | <RM250.000 (Enterprises) | <RM500,000 (Small),<br>Between RM500,000 and RM2.5 million (Medium) |   |   |   |
| Paid-up capital             |                                      |                          |   |   | <RM500,000 (Small)<br>RM501,000 – RM2.5m (Medium) |   |

Key to Table:

APEC = Asia Pacific Economic Cooperation

CCDSI= Coordinating Council for Development of Small-Scaled Industries<sup>1</sup>

BNM = Bank Negara Malaysia<sup>2</sup>

MITI = Ministry of International Trade and Industry

SMIDEC = Small and Medium-sized Industry Development Corporation

*Source: developed for this study*

**Table 6: New definitions of SMEs offered by the National SME Council (2004)**

| <b>Industry</b>   | <b>Micro</b>   | <b>Small</b>  | <b>Medium</b>   |
|---|--|---|---|
| Manufacturing, manufacturing-related services, and agro-based industries    | Sales turnover of less than RM250,000 or 5 full time employees           | Sales turnover of between RM250,000 and less than RM10 million or 5 to 50 full time employees | Sales turnover of between RM10 to RM25 million or 51 to 150 full time employees     |
| Services, primary agriculture, and information and communication technology | Sales turnover of less than RM200,000 or less than 5 full time employees | Sales turnover of between RM200,000 and RM1 million or 5 to 19 full time employees            | Sales turnover of between RM1 million to RM5 million or 20 to 50 fulltime employees |

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<sup>1</sup>Acted on behalf of the Division of Small Enterprise in the Ministry of International Trade and Industry.

<sup>2</sup> Noted in Bank Negara Malaysia lending guidelines (and under the Industrial Coordination Act 1975 (Amendment 1986) and the Promotion of Investment Act 1986)

Source: *Small and Medium Industries Development Corporation (SMIDEC), 2005*

**Table 7: Definition of SMEs adopted in this study**

| Industry  | Small         |                                  | Medium          |                                   |
|---|---------------|----------------------------------|-----------------|-----------------------------------|
|   | Employee      | Sales                            | Employee        | Sales                             |
| Manufacturing, manufacturing-related services, and agro-based industries    | 5 < Emp. < 50 | RM250,000 < Sales < RM10 million | 51 < Emp. < 150 | RM10 < Sales < RM25 million       |
| Services, primary agriculture, and information and communication technology | 5 < Emp. < 19 | RM200,000 < Sales < RM1 million  | 20 < Emp. < 50  | RM1 million < Sales < RM5 million |

Source: *developed for this study*

### **The components of financial management practice used by SMEs.**

After discussing the SMEs definition, the study will discuss the component of financial management and the techniques used in the SMEs. In this section the details of the components of financial management will be illustrated. A review of the literature has identified six components of financial management: financial planning and control, financial accounting, financial analysis, management accounting, capital budgeting, and working capital management. (Kumar, 2007; Muhammad El-Ebaishi et al, 2003; McNamara, 1997; Byun et al, 2003; Gilbert and Reichert, 1995; ZeZhong et al, 2006; Osteryoung et al, 1992; Moore and Reichert, 1983). These six components of financial management identified from the literature are shown in table 8.

**Table 8: The components of financial management**

| No. | Components of financial management | A        | B        | C        | D        | E        | F        | G        | H        | Total | Selected for this Study |
|-----|------------------------------------|----------|----------|----------|----------|----------|----------|----------|----------|-------|-------------------------|
| 1.  | Financial planning and control     | √        | √        | √        | √        |          | √        |          |          | 5     | √                       |
| 2.  | Financial accounting               | √        |          | √        |          |          |          |          |          | 2     | √                       |
| 3.  | Financial analysis                 | √        |          | √        |          |          |          | √        | √        | 4     | √                       |
| 4.  | Management accounting              | √        | √        |          |          |          | √        |          |          | 3     | √                       |
| 5.  | Capital budgeting                  | √        |          |          | √        | √        | √        |          | √        | 5     | √                       |
| 6.  | Working capital management         |          |          |          | √        | √        |          |          | √        | 3     | √                       |
|     | <b>Total</b>                       | <b>5</b> | <b>2</b> | <b>3</b> | <b>3</b> | <b>2</b> | <b>3</b> | <b>1</b> | <b>3</b> |       | <b>6</b>                |

Key to Table:

A= Kumar (2007)

B= Muhammad El-Ebaishi et.al (2003)

C= McNamara (1997)

D =Byun et al (2003)

E = Gilbert and Reichert (1995)

F = ZeZhong et al (2006)

G =Osteryoung et al (1992)

H = Moore and Reichert (1983)

*Source: developed for this study*

In conclusion, the main six components of financial management will be discussed in this study. Each of these six components of financial management have a different techniques contains specific tools and aims of their own. These techniques are described further below.



**Financial planning and control techniques used by SMEs.** The formulation of the literature shows that there are two techniques of financial planning and controls used by SMEs, as shown in Table 9.

**Table 9: Financial planning and control technique used by SMEs**

| No. | Financial planning and control technique | A        | B        | Total | Selected for this study |
|-----|--|----------|----------|-------|-------------------------|
| 1.  | Financial budgets                        | √        | √        | 2     | √                       |
| 2.  | Operating budgets                        | √        | √        | 2     | √                       |
|     | <b>Total</b>                             | <b>2</b> | <b>2</b> |       | <b>2</b>                |

Key to Table:

A = Components of financial management from literature

B = McMahon, and Scott Holmes (1991)

*Source: developed for this study*

**Financial accounting techniques used by SMEs.** Based on the four authors from their articles, there are three techniques of financial accounting used by SMEs which have been illustrated in table 10.

**Table 10: Financial accounting techniques used by SMEs**

| No. | Financial accounting technique | A        | B        | C        | D        | Total | Selected for this Study |
|-----|--------------------------------|----------|----------|----------|----------|-------|-------------------------|
| 1.  | Balance sheet                  | √        | √        | √        | √        | 4     | √                       |
| 2.  | Income statement               | √        | √        | √        | √        | 4     | √                       |
| 3.  | Cash flow statement            | √        |          | √        | √        | 3     | √                       |
|     | <b>Total</b>                   | <b>3</b> | <b>2</b> | <b>3</b> | <b>3</b> |       | <b>3</b>                |

Key to Table:

A = Components of financial management from literature

B = McMahon and Holmes (1991)

C = Mc Mahon (2001)

D = DeThomas and Fredenberger (1985)

*Source: developed for this study*

**Financial analysis techniques used by SMEs.** The synthesis of the literature shows that there are six techniques of financial analysis used by SMEs, as shown in table 11.

**Table 11: Financial analysis techniques used by SMEs**

| No. | Financial analysis technique | A        | B        | C        | D        | Total | Selected for this Study |
|-----|------------------------------|----------|----------|----------|----------|-------|-------------------------|
| 1.  | Current ratio                | √        | √        | √        | √        | 4     | √                       |
| 2.  | Quick ratio                  | √        | √        |          | √        | 3     | √                       |
| 3.  | Operating profit margin      | √        | √        |          | √        | 3     | √                       |
| 4.  | Return on asset (ROA)        | √        | √        | √        | √        | 4     | √                       |
| 5.  | Return on equity (ROE)       | √        | √        | √        | √        | 4     | √                       |
| 6.  | Debt ratio                   | √        | √        | √        | √        | 4     | √                       |
|     | <b>Total</b>                 | <b>6</b> | <b>6</b> | <b>4</b> | <b>6</b> |       | <b>6</b>                |

Key to Table:

A = Components of financial management from literature

B = Koyuncugil (2006)

C = Thomas and Evanson (1987)

D = Locke and Scrimgeour (2003)

*Source: developed for this study*

**Management accounting techniques used by SMEs.** From the input of four articles from the literature, there are four techniques of management accounting used by SMEs, as shown in table 12.

**Table 12: Management accounting techniques used by SMEs**

| No. | Management accounting technique | A        | B        | Total    | Selected for this Study |
|-----|---------------------------------|----------|----------|----------|-------------------------|
| 1.  | Standard costing                | √        | √        | <b>2</b> | √                       |
| 2.  | Just in time (JIT)              | √        |          | <b>1</b> | √                       |
| 3.  | Activity based costing (ABC)    | √        | √        | <b>2</b> | √                       |
| 4.  | Balanced scorecard (BSC)        | √        |          | <b>1</b> | √                       |
|     | <b>Total</b>                    | <b>4</b> | <b>2</b> |          | <b>4</b>                |

Key to Table:

A = Components of Financial Management from literature

B = Ghosh and Yoke (1997)

*Source: developed for this study*

**Capital budgeting techniques used by SMEs.** There are five techniques of capital budgeting used by SMEs which have been illustrated in table 13.

**Table 13: Capital budgeting techniques used by SMEs**

| No. | Capital budgeting technique      | A        | B        | C        | D        | Total    | Selected for this Study |
|-----|----------------------------------|----------|----------|----------|----------|----------|-------------------------|
| 1.  | Accounting rate of return (AROR) | √        |          | √        | √        | <b>3</b> | √                       |
| 2.  | Payback period                   | √        | √        | √        | √        | <b>4</b> | √                       |
| 3.  | Net present value                | √        | √        | √        | √        | <b>4</b> | √                       |
| 4.  | Profitability index              | √        | √        |          | √        | <b>3</b> | √                       |
| 5.  | Internal rate of return (IRR)    | √        | √        | √        | √        | <b>4</b> | √                       |
|     | <b>Total</b>                     | <b>5</b> | <b>4</b> | <b>4</b> | <b>5</b> |          | <b>5</b>                |

Key to Table:

A = Components of Financial Management from literature

B = Lazaridis (2004)

C = Filbeck and Lee (2000)

D = Ryan and Ryan (2002)

*Source: developed for this study*

**Working capital management techniques used by SMEs.** There are four techniques of working capital management used by SMEs which have been illustrated in table 14.

**Table 14: Working capital management techniques used by SMEs**

| No. | Working capital management technique | A        | B        | C        | D        | Total | Selected for this Study |
|-----|--------------------------------------|----------|----------|----------|----------|-------|-------------------------|
| 1.  | Cash management                      | √        | √        | √        | √        | 4     | √                       |
| 2.  | Account receivable management        | √        | √        | √        | √        | 4     | √                       |
| 3.  | Inventory management                 | √        | √        | √        |          | 3     | √                       |
| 4.  | Account payable management           | √        |          | √        |          | 2     | √                       |
|     | <b>Total</b>                         | <b>4</b> | <b>3</b> | <b>4</b> | <b>2</b> |       | <b>4</b>                |

Key to Table:

A = Components of Financial Management from literature

B = Cooley and Pullen (1979)

C = Khoury et al (1999)

D = McMahon and Holmes (1991)

### **Conceptual framework**

In the previous sections, we have presented the definitions of SMEs from the Malaysian and other countries' followed by the discussion about financial management components and financial management techniques and tools of each component.

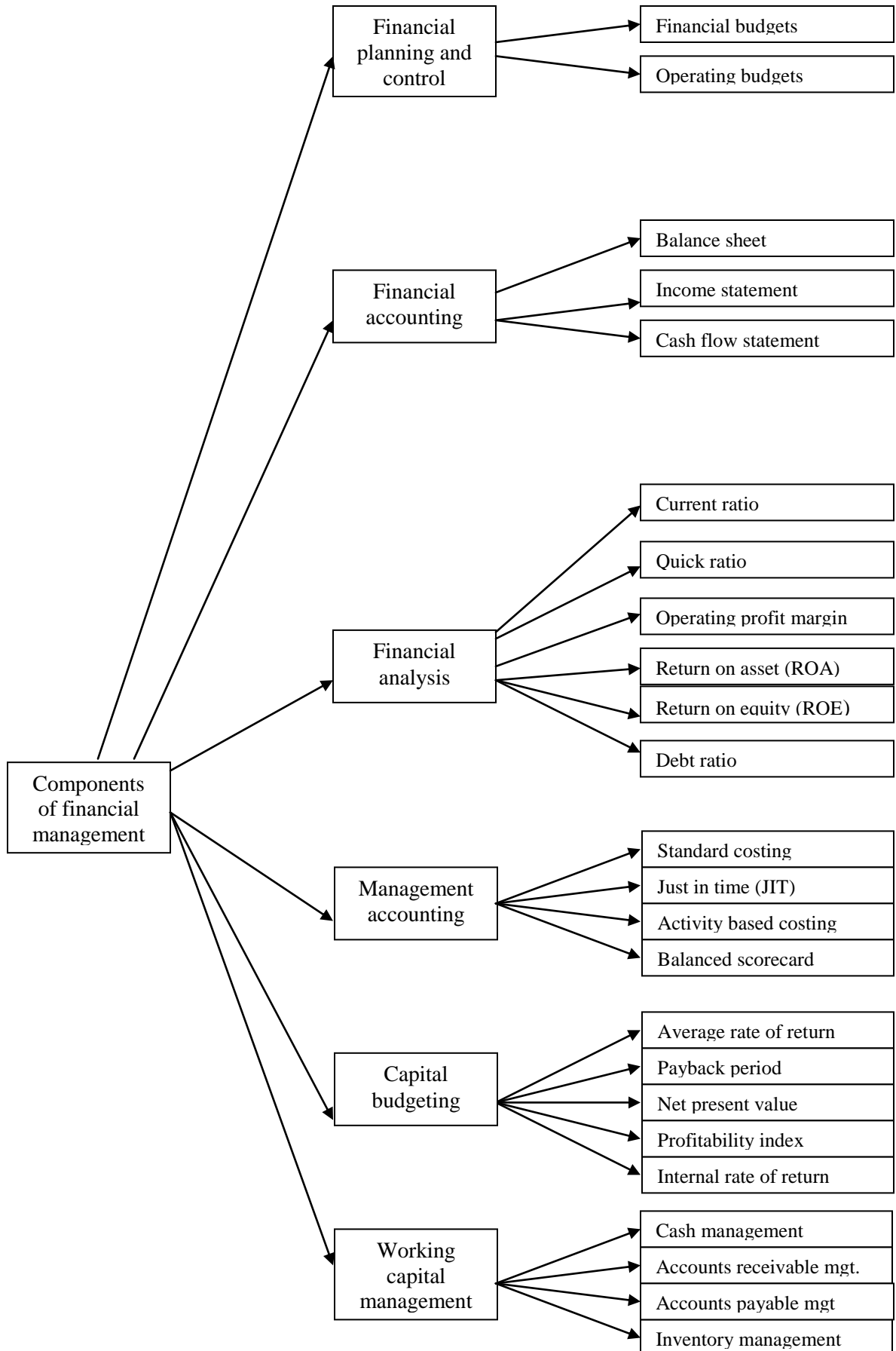
From the previous discussions, we found that all six financial management components are important in the financial management techniques practiced by the SMEs. From that summary, a conceptual framework has been built (refer figure 1). This theoretical framework will be used as a platform to investigate further the importance of financial management practices used by the SMEs.

## **Methodology**

To answer the research objectives, this study used a structured questionnaire to obtain data and information about financial management tools being used by the SMEs. The questionnaires were administered using face to face interviews. The targeted sample is the SMEs operating in the state of Kedah Darul Aman. In the present study, SMEs are defined based on the criteria provided by the Secretariat to National SME Development Council, Bank Negara Malaysia. According to the criteria, SMEs can be defined according to total number of full time employees (between 5 and 150 employees) or total sales turnover (between RM250,000 and RM25 million).

Based on these selection criteria, 30 SMEs were selected. The researcher conducted a face to face interview with the financial manager or the owner of each firm. The method of personal interview was chosen rather than using mail survey since the researcher was concerned that the response rate to mailed questionnaire might be poor. The researcher was also under a tight schedule and had to collect the data within the shortest time possible.

**Figure 1: Six financial management components and techniques**



*Source: developed for this study*

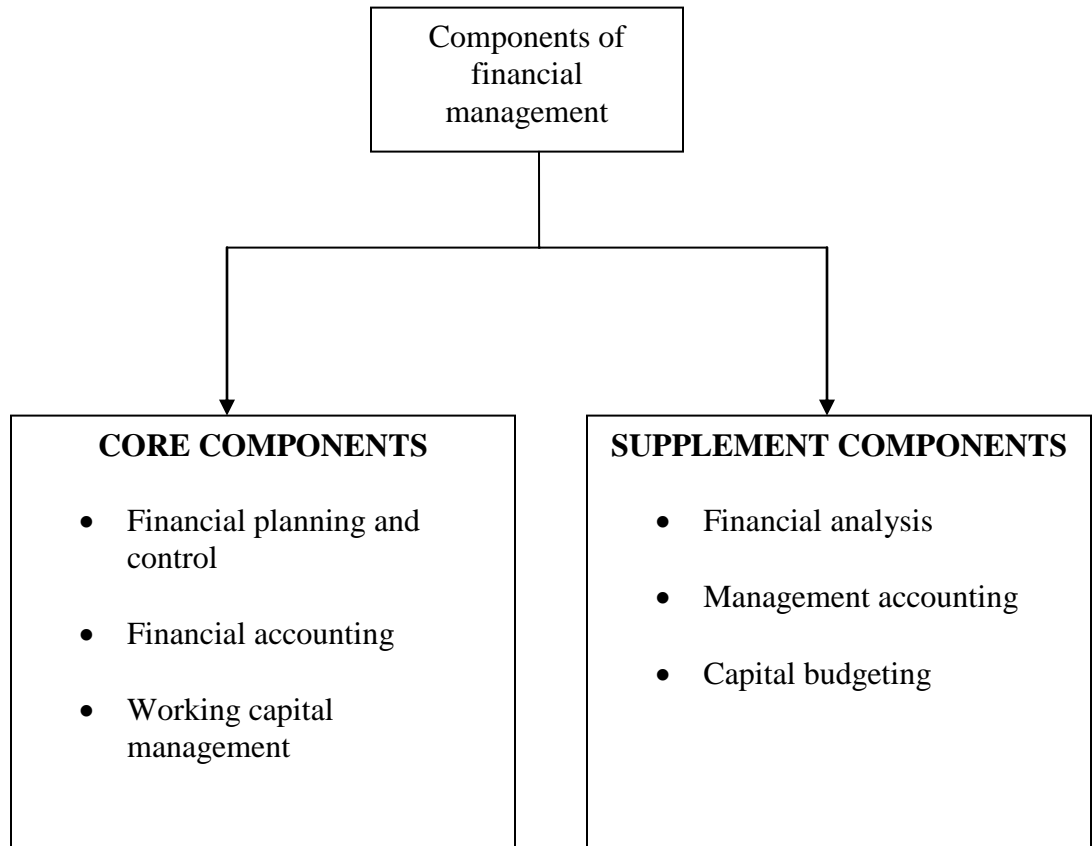
The researcher included six financial management components in the survey questionnaire. These components were chosen based on theories and on previous empirical works. The survey questionnaire adopted in the study consists of three sections. Section A involves questions to establish the basic profile of the respondents' organizational structure, section B contains questions used to identify the financial management tools used by the SMEs, while section C involves questions regarding the individuals being interviewed.

### **Findings & Conclusions**

This study was designed to address the research question: *What are the financial management techniques practiced by the SMEs in Malaysia?* Based on the data analysis of this study, two new models could be designed to confirmed the literature and as a contribution to the body of knowledge. Firstly, the six components of financial management as discussed in the literature review could be categorized into two: core components and supplementary components. Three components could be categorized as core components and the others three could be categorized as supplementary components, as shown in figure 2.

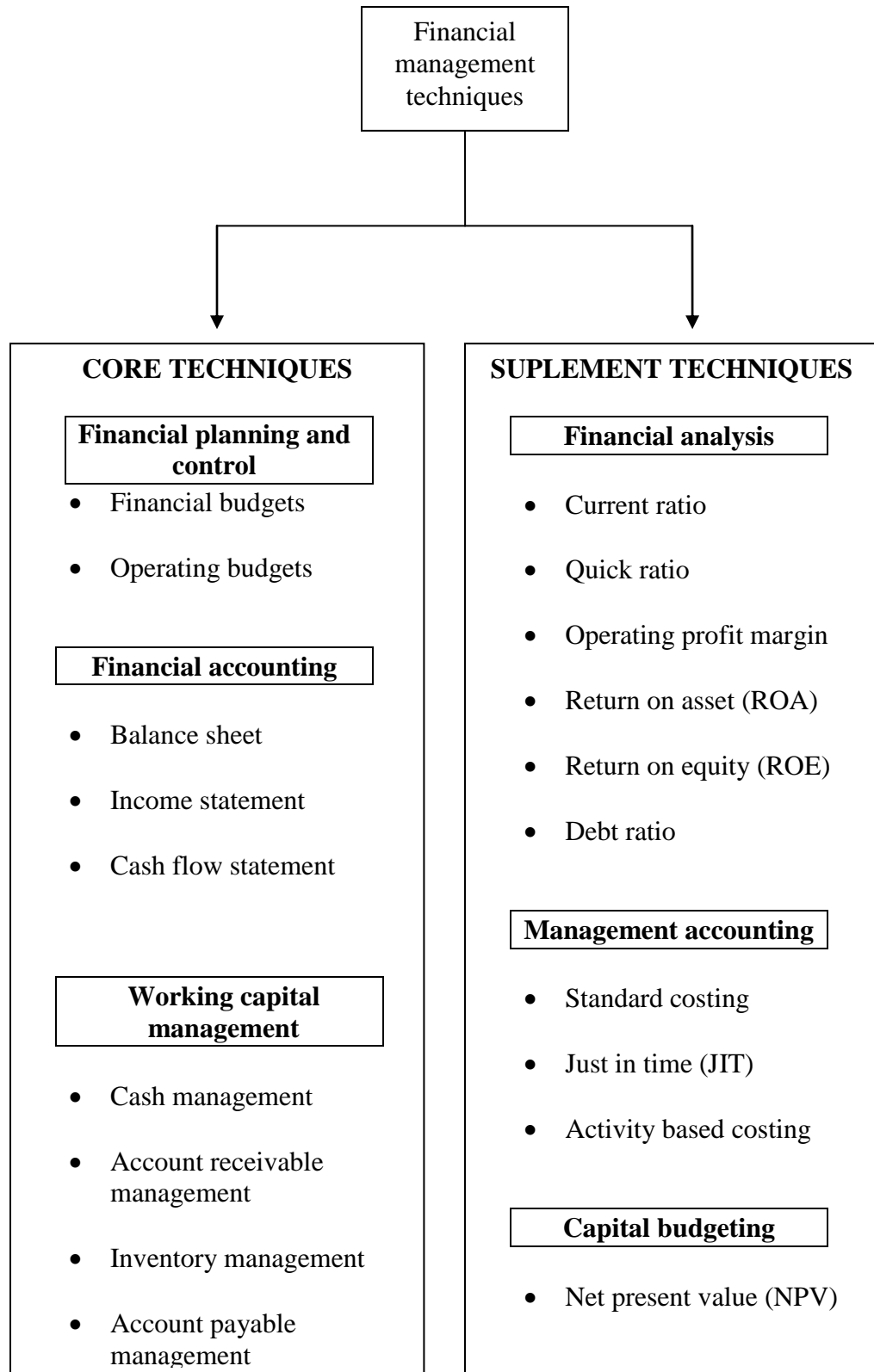


**Figure 2: Components of financial management practice used by SMEs**



Secondly, 19 techniques of financial management used by SMEs have been confirmed from the data analysis to be included in this study. These techniques are categorized into two which are core techniques and supplementary techniques. From the 19 techniques listed, nine are included in core techniques and 10 are included in supplementary techniques, as shown in figure 3.

**Figure 3: Financial management techniques used by SMEs**



The findings indicate that the range of financial management tools used by the SMEs in the survey is still low. Many still use only predictable and often used components such as financial accounting and working capital management. Out of the six components of financial management, only three are being practiced by a high percentage of the SMEs in the survey. These are financial planning and control, financial accounting, and working capital management. Three other components, namely management accounting, capital budgeting, and financial analysis are being practiced by only a small percentage of the SMEs. However, because of the important impact of all six components of financial management on the well being and survival of their business, managers of SMEs should seriously consider making financial management an important priority in their overall management. The model designed for this research could be adopted by the SMEs for their financial management. All six of the financial management components should be given priority by the SMEs.

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