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Determinants of Financial Performance of SME; In Case of Gamo Zone, Arba Minch Town, Southern Ethiopia;

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ABSTRACT

Financial reporting system of an entity is essential to ensure that the economic resources of the SME are used in efficiently and effectively in pursuit its goals. Globally, the most successful companies use financial records as a basis for performance of SMEs. The study aims to identify to identify the determinants of financial performances of SMEs in Gamo Zone; Arba Minch Town. To achieve the "general and specific objectives" this study were used descriptive research design and quantitative research approach. The primary sources of data were collected from SME who were engaged on service, manufacturing and merchandising business. The sampling techniques were used for this study is stratified sampling technique. However, the sample will be selected from 92 SMEs members who were engaged service, manufacturing and merchandising business. For data analysis, multiple liner regression model and descriptive statistics including mean, std. deviation, frequency and percentages were used. Finally, these studies conclude that financial reporting practice, financial management practice, recordkeeping and inventory management systems are positively or significant relationship with financial performances of SMEs. Hence, to increase the financial performances of SMEs, it is suggests the SMEs supervisor, SMEs owners and Government bodiesto improve the knowledge and awareness of SMEs related with financial management, recordkeeping, inventory control and preparation of financial statement. The concerned bodies to solve financial factors by provide chances to get access to finance, technology, skilled man power, marketing areas and necessary infrastructure.

Keywords: *SMEs, financial reporting, financial management, recordkeeping, financial performance*

BACKGROUND OF THE STUDY

The Small and Medium Enterprise sector is a backbone of the all developed as well as the developing nations. In recent times, small and medium sized enterprises (SMEs) have been given due recognitions especially in the developed nations for playing very important roles towards fostering accelerated economic growth, development and stability within several economies. They make-up the largest proportion of businesses all over the world and play tremendous roles in employment generation, poverty alleviation, provision of goods and services, creating a better standard of living, income generation and regional development as well as immensely contributing to the gross domestic products (GDPs) of many countries (Ronita 2012). In the context of SME's financial accounting practices is important as it can help firms manage the short run problems of SMEs in critical areas such as cash flow, costing and expenditure by providing information to monitor and control the business. Decision makers can take sound economic decisions if there is proper accounting information. (Rathnasiri, 2014).

In this regards, sound financial management is crucial to the survival, growth and financial performance of SME's and this has been identified by prior studies (McMahon and Holmes 1991; Gorton 1999). Financial reporting system of an entity is essential to ensure that the economic resources of the SME are used in efficiently and effectively in pursuit its goals. Globally, the most successful companies use financial records as a basis for performance (Bowen, Schoppe, &Vassa, 2009). Indeed, according to Onaolapo and Adegbite (2014), the variation in financial performance of Small and Medium Enterprises (SMEs) can largely be explained by the level of accounting record keeping. Regionally, studies indicate that in most African countries, record keeping has been embraced as a driving factor for firms' financial performance. Financial record keeping has become the foundation on which modern businesses succeed for growth and sustainability (Ademola, Olukotun, Samuel, & Ifedolapou, 2012). Businesses are highly dependent on financial records kept in the books of accounts indicating different transactions such as sales, purchases, income, and payments by an individual or organizations (Dawuda & Azeko, 2015).Good financial records, can greatly improve many of the management decisions a business owner and or manager takes, including decisions about marketing, personnel, borrowing, pricing, inventory, and product development (Muchira, 2012). It is widely believed that record keeping has a significant impact on financial performance of a given business. For instance, Onaolapo (2014) asserts that record keeping gives substantial information about the financial strength and current performance of an enterprise and therefore managers find those records useful in making decisions. Muchira (2013) emphasizes that good record keeping will make any business partner or investor more aware of what is going on in their businesses and it will save them money. Research by Chelimo and Sophia (2014) revealed that about 60% of small businesses fail within the first three years due to management inefficiencies brought about by poor record keeping. This is in line with Ademola et al. (2012) whose study agrees that poor records can lead to financial inefficiency of small and medium enterprises hence leading to poor organizational performance. Indicators of poor financial record keeping were given by Onaolapo et al. (2014) whose study found out that poor financial recordkeeping manifests through lack of knowledge, low level of education, inadequate trainings and limited resources. Despite having all the above studies, there is limited research on the effect of financial reporting on financial performance of SMEs in Ethiopia especially in Gamo Zone Arba Minch Town**.** Therefore, this study was conducted to find out the effect of financial Reporting on financial performance of SMEs in Gamo Zone Arba Minch Town**.**

Statement of the Problem

Most of the large businesses in Ethiopia have started as Small and Medium and have grown to their maturity over long a period by cumulating capital and business management experiences. In Ethiopia, despite the enormous importance of the SME sector to the national economy with regards to job creation and the alleviation of abject poverty, many of the SMEs are unable to realize their full potential due to the existence of different factors that inhibit their growth and performance (Mulugeta, 2010).

Basically, the primary concern in SME financial reporting generally relates to preparation and use of general purpose financial reports such as the statement of financial position, income statement, and the cash-flow statement. Financial reporting system of an entity is essential to ensure that the economic resources of the SME are used in efficiently and effectively in pursuit its goals. In the context of SME's financial accounting practices is important as it can help firms manage the short run problems in critical areas like costing, expenditure and cash flow by providing information to support monitoring and control Son et al (2006). Poor record keeping, inefficient use of accounting information to support their financial decision-making and the low quality and reliability of financial data are part of the main problems in financial management concerns of SMEs (Sarapaivanich, 2003). According to Eloho (2 016) the inefficient use of accounting information and poor record keeping are affected to the financial decision-making and low quality financial data. These are the main problems which financial management has to concern. Proper record keeping is a useful system for making sound economic decisions and the success of the business. The misuse, poor record keeping, untimely and inaccuracy of accounting information effects to inaccurately assess of the financial situation of SME and make poor financial decisions.

A case in point is that of Okoli (2011) who links proper record keeping to profitability of small scale enterprises in Nigeria and argues that the lack of proper record keeping makes it impossible for owners of small business to do critical assessment of their performance, and he thus calls for the maintenance of proper record keeping in enhancing their profitability and performance. In a similar assessment conducted by Mairura (2011), the level of education, type of business ownership, number of employees, and ageof business were drivers of record keeping in Nairobi, Kenya. However, Mairura (2011) failed to empirically establish the correlation between book keeping and business performance.

On the other hand, using a more formal approach, Akande (2011) examined, accounting skill as a performance factor for small business in Nigeria by invoking chi-square test statistic. Results from the above study show that possession of proper accounting skills by business owners significantly improves business performance. Specifically, it is realistic to anticipate that the financial reporting practices found in SMEs in Nigeria may not accord with mandated, recommended or preferred practices in some or all of a number of specific respects, not all financial statements may be prepared in terms of statement of financial position, income statement and cash-flow statements, financial statements may not be prepared with sufficient detail with regards to generally accepted accounting principles and the specific requirements of applicable accounting standards, financial statements may be prepared irregularly or infrequently, financial statements may not be used appropriately with regards to routine analysis and interpreted using accepted techniques such as inspection of key figures, trend analysis, inter-firm comparisons and variance analysis. In another study Muhindo et al. (2014), found out that the major problem facing SMEs is lack of or inadequate accounting information systems which result into continuous low performance levels.

The seeds of present study are sowed in attempting to find major influencing factors or bottlenecks that affect the financial performances of SMEs in Ethiopia. It is believed that the factors influencing the financial performances of SME would vary depending on Poor record keeping, inefficient use of accounting information, poor or careless financial management, low quality and reliability of financial data capital, poor asset quality, poor governance, poor profitability and poor liquidity. To facilitate the present study, the causes for financial performances of SME are: financial reporting practice, financial management practice, financial record keeping preparation and inventory management system are the major independent variables which affect the dependent variable.

There is limited information that relates to the determinants of financial performance of small and medium enterprise in Ethiopia. Therefore, this study seeks to fill the existing research gap by answering the research question,

1. What are the impacts of financial reporting practices affect the financial performances of SMEs?
2. To what extent the financial management practices affect the financial performance of SMEs?
3. What are the impacts of financial record keeping preparation affect the financial performance of SMEs?
4. What are the impacts of inventory management systems affect the financial performance of SME?

Research Objective

The general objective of this study is to identify factors affecting the financial performances of small and medium enterprises in Gamo Zone, Arba Minch Town.

Based on the general objective the following specific objectives are drawn.

- To assess the impact of financial reporting practices on financial performance of SME.
- To investigating the impact of financial Management practice on the financial performance of SME.
- To examine the impact of financial statement preparation on the financial performances of SME.
- To evaluate the impacts of inventory management system on financial performances of SME.

Research Hypothesis

In order to reply the questions of the research, the following hypothesis were developed.

1. H1: There is no relationship between financial reporting practices and financial performance of small and medium enterprise.

   H1A: There is a significant relationship between financial reporting practices and financial performance of small and medium enterprise.

2. H2: There is no relationship between financial management practices and financial performance of SME.

   H2A: There is a significant relationship between financial management practices and financial performance of SME.

3. H3: There is no relationship between financial record keeping preparation and financial performance of SME.

   H3A: There is a significant relationship between financial record keeping preparation and financial performance of SME.

4. H4: There is no relationship between inventory management system and financial performance of SME.

H4A: There is a significant relationship between inventory management system and financial performance of SME.

Literature Review

Theoretical Review

Overview of Small and Medium Enterprises in Ethiopia

The SME sector everywhere is characterized by highly diversified activities which can create employment opportunities for a substantial segment of the population. This implies that the sector is a quick remedy for unemployment and poverty problem. The realization of a modest standard of living through curbing unemployment and facilitating the environment for new job seekers and self-employment requires a direct intervention and support of the government and other concerned stakeholders (Mulugeta, 2010).

In line with this, Tegegne and Meheret (2010) cited in (Admasu, 2012) argued that the absence of a single or globally applicable definition has made the task of counting the number of SMEs and assessing their impact extremely difficult across countries, though the rationale for most governments to make such definition and categorization is mainly for functional and promotional purposes to achieve the desired levels of development of the sector.

Mekonnen, (2014) regarding the definition of the term SMEs universally accepted definition is not yet given. This is because of the heterogeneity of SMEs themselves and the nature of the economy in which they operate. This becomes the agent for the absence of establishing feasible global definitions that can be used everywhere in the same manners. Due to this and the other related factors, different countries use different criteria such as the number of employees, assets, employed capital, sales turn over, or combination of the above factors to determine the size of the enterprises. For instance, the most common definitions used by regulators are based on the number of employees, sales and/or loan size.

Amare and Raghurama, (2017) Though Micro, Small and Medium Enterprises constitute the major share in terms of number in Ethiopia; there is no consistently placed definition for the subsector by different bodies. To align the definition with at least some countries and international organizations, the country has revised the definition of Micro and Small Enterprises in 2011. In the new definition, some of the attributes used by other countries and international organizations are addressed. In addition, the definition has segregated sectors as service and manufacturing. However, there is still confusion among different governmental organizations (e.g. Ministry of Trade, Central Statistics Agency, & Federal Micro and Small Enterprises Development Agency (FMSEDA) in defining MSEs. Moreover, since it only focuses on Micro and Small Enterprises, the new definition does not put any demarcation between Small and Medium; and Medium and large Enterprises. Federal Micro and Small Enterprises Development Agency (FMSEDA), on the other hand, put the definition of Micro and Small Scale Enterprises and categorize them from support provision perspective which contempt Medium Enterprises. With these precincts in defining and characterizing Micro, Small and Medium Enterprises in Ethiopia, adopting definition of MSMEs with slight modification is compulsory.

Table 2.1: *Definition of MSEs in Ethiopia by Regulation No. 201/2011*

Level Of The Enterprise	Sector	Human Power	Total Asset
Micro enterprise	Industry	≤ 5	≤ 100000($6000 or E4500)
	Service	≤ 5	≤ 50,000($3000 or E2200)
Small enterprise	Industry	6-30	≤ birr 1.5 million ($9000 or E70000)
	Service	6-30	≤ birr 500,000($30000 or E 23000)

Source: FMSEDA, 2011

According to Regulation No. 373/2016, Federal Small and Medium Manufacturing Industry Development Agency defined "**Small Manufacturing Industry**" means an industry having a total capital, excluding building, from Birr 100,001 to Birr 1,500,000 in the manufacturing sector and engages from 6 to 30 workers including the owner, his family members and other employees and "**Medium Manufacturing Industry**" means an industry having a total capital, excluding building from Birr 1,500,001 to Birr 20,000,000 in the manufacturing sector and engages from 31 to 100 workers including the owner, his family members and other employees; whereas under Regulation No. 374/2016 Federal Urban Job

Creation and Food Security Agency defined "**Small Enterprises**" means an enterprise having a total capital, excluding building, from Birr 50,001 to Birr 500,000 in the case of service sector or Birr 100,001 to Birr 1,500.000 in the case of urban agriculture, artisanal mining, and construction sector engages from 6 to 30 workers including the owner, his family members and other employees.

Financial Performance of SMEs

According to Firer & Williams, (2003) the management always tray to maximize the owner's wealth of the business by maximizing the value of its shareholders. The market price of the common stock is the value of the firm, which is a reflection of the investment, financing, and dividend decisions that represents prospective future earnings per share, risk of earnings, and any other factors which effect to the market price of the stock. The market price assists as a performance index or a report card on the progress of the firm. Poor accounting and management practices are major factors that resist financial performance of SMEs and it disturbs to raise finance. Information asymmetries related with the lending from borrowers to smaller enterprises. Because of these non-financial reasons, a large number of small and medium enterprises have to face different types of failure. And also lack of basic management experiences and poor record keeping contribute to the failure of small business.

Financial Reporting Practices in Small and Medium Enterprises

The primary concern in SME's financial reporting practices is the preparation and use of financial reports such as the statement of financial position, the income statement, and the cash-flow statement. Both historical and future-oriented financial reporting might also be expected. And also financial reporting practices are extending to the analysis and interpretation of the historical financial statements.

IASB requires SMEs to prepare financial statements such as Statement of Financial Position, Statement of Comprehensive Income, and Statement of Changes in equity, Statements of Cash flows and notes to the Financial Statements examined the importance of financial reporting and analysis; unfortunately found that these practices are lacking and inadequate among SMEs. Financial reporting involves communicating financial information to the management and other stakeholders that regarding to the performance of the business throughout the specific time period. It helps to the management, investors and other stakeholders to take sound economic decisions Dawuda & Azek, (2015), Abusomwan & Oghogho (2016).

There is limited usage of financial reports that attributed to the inability to employ professional managers of SMEs with functional specialization in the financial area due to limited financial resources of them. SMEs are losing out without effective and adequate financial reporting and analysis practices such as improved ability to anticipate fortunes or failures, improved monitoring of financial health and progress, greater ease in financial planning and control and better assessments of financial risks.

Financial Management Practices in Small and Medium Enterprise

However, Meredith (1986) asserts that financial management is concerned with all areas of management, which involves finance not only the sources, and uses of finance in the enterprises but also the financial implications of investment, production, marketing or personal decisions and the total performance of the enterprise. Further he argued financial management is concerned with what is going to happen in the future. Its purpose is to look for ways to maximize the effectiveness of financial resources.

McMahon et al. (1993), modern financial management involves planning, controlling and decision making responsibilities embracing: Various types and sources of finance an enterprise may employ and how these may be accessed, and how to choose among them. Alternative ways in which finance raised may be used in an enterprise and how to select those that are likely to prove most profitable. Different means of ensuring that finance entrusted to specific activities to realize the returns that were anticipated on its allocation to them.

According to (Padachi, 2012) a large number of SMEs failure due to inability of skilled financial managers and accountants to plan and control current assets and current liabilities of their firms. In particular, SMEs face serious problems due to their specific characteristics and operating conditions. SMEs face resource poverty such as capital, knowledge, proper accounting packages and time creates a situation where responsibilities for managers of the firm. Thus management time, scarce resource and thus has a high opportunity cost. Certain these constraints, SMEs have limited time and other resources to provide a proper training in financial management skills in reporting practices include leading accountants to keep financial records well and other management activities.

Financial Recordkeeping in SMEs

Ademola, Olukotun, Samuel, &Ifedolapou, (2012) financial record keeping has become the foundation on which modern businesses succeed for growth and sustainability. Businesses are highly dependent on financial records kept in the books of accounts indicating different transactions such as sales, purchases, income, and payments by an individual or organizations

Hussein (1983) notes that, a good accounting system is not only judged by how well records are kept but by how well it is able to meet the information needs of both internal and external decision-makers.

Tanwongsval and Pinvanichkul (2008) Different opinions have continued to emerge on how accounting records can affect growth of the small scale businesses in Nigeria. Some aspects of the existing research delve into the relationship between record keeping and performance of firms. Comment on the reasons why SMEs prepare financial statements, and argue that on the list, SMEs rank assessing profitability second to the purpose of tax returns.

According to Ismail and King (2007), the development of a sound accounting system in SMEs hinge on owners level of accounting knowledge and skills. Some authors have argued that small businesses use professional accounting firms for preparation of annual reports and for other accounting needs.

Clute and Gitman (1980) uphold that it is common for qualified accountants to do a good job of keeping records up to date but they fail to provide information needed by decision-makers. Interestingly, however, others argue that the high cost of contracting professional accountants has left SME owners with no better option but to relegate management of accounting information

Muchira, (2012) Good financial records, can greatly improve many of the management decisions a business owner and manager takes, including decisions about marketing, personnel, borrowing, pricing, inventory, and product development Such financial records include; income statement, statement of financial position (balance sheet), the statement of Cash flows, and the financial internal control system records that check the accuracy of company transactions

For instance, Onaolapo (2014) asserts that record keeping gives substantial information about the financial strength and current performance of an enterprise and therefore managers find those records useful in making decisions.

Complementarily, Muchira (2013) emphasizes that good record keeping will make any business partner or investor more aware of what is going on in their businesses and it will save them money. Research by Chelimo and Sophia (2014) revealed that about 60% of small businesses fail within the first three years due to management inefficiencies brought about by poor record keeping. Indicators of poor financial record keeping were given by Onaolapo et al. (2014) whose study found out that poor financial recordkeeping manifests through lack of knowledge, low level of education, inadequate trainings and limited resources. Despite having all the above studies, there is limited research on the effect of financial record keeping on financial performance of organizations in Uganda especially in development groups**.**

Inventory Management System

Inventory management has significance important for any enterprise, an inventory concentrates manufacturing sector because effective practices in inventory management allow minimizing inventory costs. Therefore, avoid the horrible consequences which are coming with a shortage of material. This succession of events has a special significance in SMEs and inventory management. (Eloranta&Raisanen, 1998) argue that poor quality of inventory forecasts is main factors that contributing to this sequence of events in SMEs. According to (Chikan, 1990) combined production-inventory system is a conclusive success factor under a variety of conditions. However, regarding performance, SMEs are frequently satisfied with the year-end stocktaking, profit and loss accounts. The statement of financial position rules even many benefits can be derived from applying a perpetual inventory system. This type of inventory system, all the stock items is randomly and periodically checked over the year. But many SMEs are lack of professional expertise and take decisions generally based on the intuition and elementary inventory management practices, investments in inventory are not always measure accurately or appropriately. Inventory management is a crucial event to the SME because mismanagement of inventory management may threaten to the enterprise's survival (Sprague & Wacker, 1996).

Empirical Reviews

Worldwide Literatures

Chuthamas *et al*, (2011) the research conducted on Factors Affecting Business Success of Small & Medium Enterprises (SMEs) in Thailand. The regression analysis result shown that the most significant factors affecting the business success of SMEs in Thailand were SMEs characteristics, customer and market, the way of doing business, resources, and finance, and external environment.

Rosli, (2011) in title with the determinants of small and medium enterprises performance in the Malaysian auto-parts industry; the results indicate that there are positive relationships between the specified dependent and independent variables. However, only two variables - age and foreign participation are significantly related to the performance of SMEs. This consolidates the earlier expectations and studies that age and foreign ownership do matter to the performance of SMEs. Firm-specific factors are more important than any other factors in determining firm performance.

Farah and Nina, (2016) to examine factors affecting profitability of SME; The results showed that firm size, growth, lagged profitability, productivity, and industry affiliation significantly effect on profitability. While the variable that firm age does not significantly influence profitability. The results of the regression coefficient indicate that the variables firm size, growth, and lagged profitability have a negative effect on profitability, While the variable productivity, and industry affiliation have a positive impact on profitability.

Sumaira and Javaria, (2013) the research conducted on the impact of working capital management on the profitability of SMEs in textile sector of Pakistan; the results of regression analysis concluded that Aggressiveness of working capital management policies is negatively associated with profitability. Moreover, liquidity and size of the firm have a positive relationship with profitability whereas debt ratio is negatively correlated with profitability.

According to (Alexandru and Radu, 2014) on the title of The Financial factors that Influence the Profitability of SMEs in Romania; by using OLS (ordinary least squares)the results showed that managerial decisions on investment can influence decisively the profitability of SMEs especially in a period of economic instability. From an economic point of view, financial returns are positively influenced by the turnover and interest coverage and negatively influence by the leverage and the share of fixed assets in total assets, because a high value of it can mean a high cost of debt and therefore higher interest rates and an increase of ROIC.

McMahon and Davies (1994), (McMahon 1998) these studies investigate the types of financial reports produced by SMEs in Australia; The findings indicate that financial reports for SMEs are prepared predominantly by external accountants at annual intervals, and they normally comprise just the balance sheet and the profit and loss statement. The content and presentation of financial reports appear to be greatly influenced by taxation and corporate statutory reporting requirements.

A similar finding was found by Jarvis et al. (1996). The lesser use of published industry data, credit rating agency data and statutory accounts could be explained by their relevance more to larger companies as small firms tend to have more close and personal relationships with their customers. They further noted that small firms use the services of external accountant for the preparation of the annual statutory accounts.

African Literatures

Mbugua*et al*, (2014) on the title Factors Affecting the Performance of Small and Micro Enterprises in Limuru Town, Kenya. The finding concluded that access to finance and availability of management experience are the key socio-economic factors affecting the performance of SMEs businesses in Limuru Town Market and other key factors are access to business information, access to infrastructure and government policy and regulations. According to Kinyua, (2014) in her study on

Factors Affecting the Performance of Small and Medium Enterprises in Nakuru Town, Kenya states that access to finance had the potential to positively affect performance of SMEs; management skills were found to positively and significantly affect performance of SMEs; macro environment factors were found to significantly affect performance and Infrastructure did not significantly affect performance of SMEs in the study area; the number of years in operations increased the performance increased.

Asma *et al*, (2015) in title with Establishing the Factors Affecting the Growth of Small and Medium-sized Enterprises in Algeria; the study reveals that the growth of SMEs in Algeria is hampered by several inter-related factors, which include business environmental factors that are beyond the SMEs control and internal factors of the SMEs. The external factors include the legal and regulatory framework, access to external financing, and human resources capacities. The internal factors comprise entrepreneurial characteristics, management capacities, marketing skills, and technological capacities are factors affecting the growth of SME in Algeria.

Fouad, (2013) in title with factors affecting the performance of small and medium enterprises (SMEs) in the manufacturing sector of Cairo, Egypt; the finding States that poor management skills such as human resources management, financial management, general management, production management and marketing management, economic factors due to shortage of finance, human resources management due to skills shortage are other factors affect the performance of SMEs in the manufacturing sector of Cairo, Egypt.

Fredrick, (2016) Conducted a research on factors that affect financial performance of small and medium enterprises in Kenya; The Regression results indicated corporate governance, human resource, access to finances are positively and significantly affect the financial performance of SME in Kenya.

Ombworo, (2014) in title with the effect of liquidity on the profitability of small and medium-sized enterprises in Kenya; the study finding conclude that liquidity has a positive but insignificant effect on profitability, leverage had a positive but insignificant effect on performance which means leverage does not affect the profitability of SMEs in Kenya. The on the other hand growth and the size of firm has a positive but insignificant effect on profitability which do not affect their profitability.

Ethiopian Literatures

According to Zemenu and Mohammed (2014) in title with of the determinants of the Growth of Micro and Small Enterprises in Ethiopia; A Case of MSEs in Mekelle City, Tigray; the finding shows that intensive competition, inadequate credit facility, starting business without conducting survey, inappropriate tax imposition, inappropriate tenure, lack of business training, shortage of working capital, absence of appropriate technology, uncollectible receivables and lack of financial management skill and experience are the top ten challenges that micro and small enterprises of Mekelle city. On the other hand among the five sectors (as categorized by the MSE agency), the service sector is the most unstable sector. On the other hand manufacturing sector is the most sustainable sector in Mekelle city.

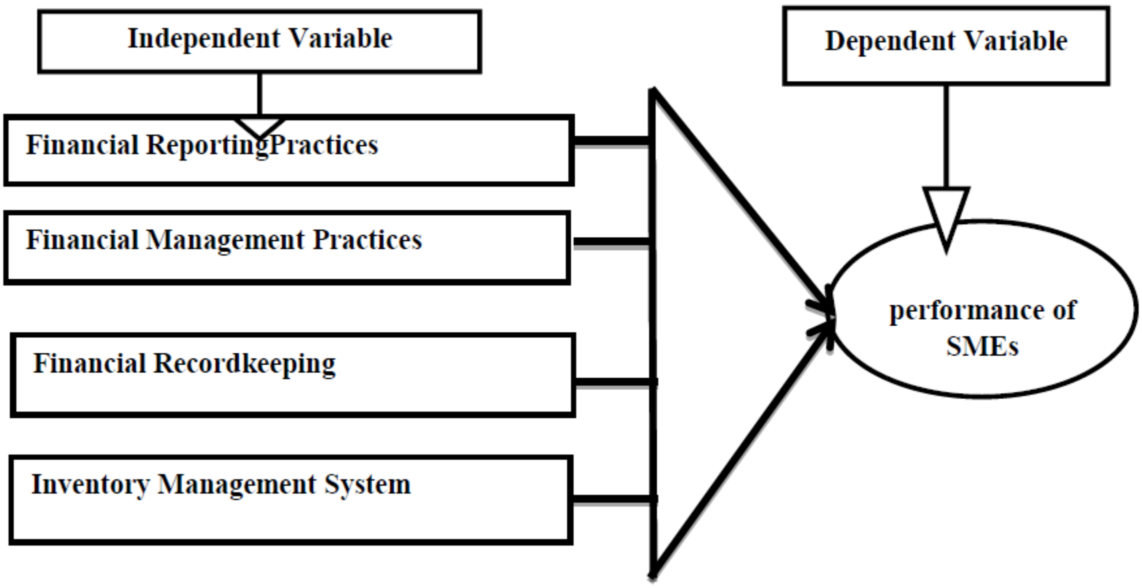
Admasu, (2012) on Factors Affecting the Performance of Micro and Small Enterprises in Arada and Lideta Sub-Cities, Addis Ababa, Ethiopia; The empirical study elicited eight major challenges which seem to affect the performance of MSEs in sub-cities which include: inadequate finance, lack of working premises, marketing problems, inadequate infrastructures, poor management practices, and technological, entrepreneurial and political and legal problems including bureaucratic bottlenecks system.

Netsaalem, (2011) Investigated the factors that affecting the performance of micro and small enterprises in Harar; The result from regression analysis depicted that, the significant factors that influence MSE performance at a different significant level were credit utilization, training, and working machinery. The result from the stakeholders' analysis showed that there is an inadequate linkage between MSE and these relevant stakeholders. This research furthermore explores the transformation capacity of MSE in the study area. The result from the relationship between profitability and transformation capacity of the MSE showed that 33.3 % of the respondents on aggregate said that their enterprise is less capable or unable to transform to medium or large scale enterprises and 21.5%

said they don't know the capacity of transformation.

Conceptual Framework

The conceptual frameworks focus on the determinants of financial performance of small and medium enterprises. The variables in the conceptual framework are tested as hypotheses to establish the relationships between variables. The independent variables of this study include the reporting practice, financial management practice, financial recordkeeping, inventory management system. The dependent variable is financial performance of SMEs.



Source; Developed by the researcher 2020

Fig1. *Conceptual Frame Work Model*

Variables Measurements

Dependent Variables; - The dependent variable for this study were Financial performance of SMEs is measured byReturn on assets and Net profit.

- **Return on Asset: -** Return on Asset (ROA) describe that how profitability of a company relative to its total assets. It gives an idea how to manage the assets of the company efficiently to generate earnings. ROA can be calculated as follows;

$$Return\ on\ asset = \frac{Net\ incom}{Total\ asset}$$

- **Net Profit; -** Net profit is the revenue after deducting operation expenses, interest, tax, and dividend on preferred stock. *Net Profit = Total Revenue – Total Expenses*

Independent Variables; - For this study four independent variables were identified

- **Financial Reporting practice; -** Financial reporting practices are measured by relevance, accuracy and timeliness.
- **Financial management practices;-** the financial management practices are measured by Financial planning, Uses and acquisition of funds, Financial decision, Improving profitability
- **Financial record keeping;-** the financial record keeping are measured by Accounting record, Accounting knowledge and awareness, Qualified Accountants, Bookkeeping and Accounting procedures
- **Inventory Management system;-** the inventory management are measured by Physical safeguards of inventory against theft, Determine the level of inventory , Inventory count, Periodic summery of inventory usage

RESEARCH METHODOLOGY

To achieve the objective of the study, this study was used descriptive research design and quantitative research approach based on survey design with a structured questionnaire. In this study the researcher used stratified sampling technique. The total sample size was the 92 who were engaged on manufacturing, merchandising and service giving SME in Arba Minch Town. The sample size of the study was determined using Yamane (1967) formula: n = $\frac{N}{1+N(e)2}$

N = 120 which is the total population and significant level is (e) =0.05. Then, the sample was; $\frac{120}{1+120(0.05)2}$ = 92; ample that expecting can represent the total population.

In this study the multiple linear regression models were used for data analysis. The following regression model was used in this study;

SMEFP = β0 + β1FRP+ β2 FMP+ β3FRK + β4IMS+ ε….

Where,

SMEFP= Financial performance of SMEs are measured by return on assets and net profits of the firm; it is also measure using the questionnaire.

FRP= Financial Reporting practices; are measured by the relevance, Accuracy, timeliness

FM= Financial Management Practices, are measured by Financial planning, Uses and acquisition of funds, Financial decision, Improving profitability

FRK= Financial record keeping, are measured by Accounting record, Accounting knowledge and awareness, Qualified Accountants, Bookkeeping and Accounting procedures.

IMS= Inventory Management System, are measured by Physical safeguards of inventory against theft, Determine the level of inventory, Inventory count, Periodic summery of inventory usage

ε = error term

Analysis and Discussion

Descriptive Statistics Result

Table: 4.1 Descriptive Statistics of Independent Variables

Item	Descriptive Statistics			
	Disagreement	**Agreement**	**Mean**	**Std.Devotion**
Poor Financial Reporting Practices	***23.69%***	***76.31%***	***3.95***	***0.441***
Poor Financial Management Practices	***16.55%***	***83.48%***	***4.21***	***0.523***
Inadequate recordkeeping	***11.16***	***88.84***	***4.64***	***0.058***
Poor Inventory Management System	***20.93%***	***79.07***	***4.00***	***0.531***

(Source – Survey Data, 2018)

The survey results indicated in the above table 4.2 shows that;-

- According to "**Financial reporting practice"** the respondent gives their opinion with the cumulative results rate at 76.31% agreed with the mean value of 3.95 and the std. deviation of 0.441. The finding reviled that poor financial reporting practices due to financial report couldn't to address the current needs of the users, report does not contain description and variation of the potential needs of users and reports can not satisfied potential needs of external users for the last three years, financial reports are not free from errors, reports are not complete with format and reports have a measurement errors. This implies that relevance, accuracy and timeliness affect the financial reporting practices in SMEs.
- According to "**Financial Management practice"** the respondent gives their opinion with the cumulative results at 83.48% agreed with the mean value of 4.21 and the std. deviation of 0.523. The finding show that poor financial management practice due toLack of adequate financial planning, Inadequate uses and acquisition of funds, Taking poor financial decision, Poor financial controlling device such as budgetary control, ratio analyses and cost volume profit analyses are affect financial management practices. This implies that poor financial management practices are significant affect the financial performance of SMEs.
- According to "**Financial Recordkeeping"** the respondent gives their opinion with the cumulative results at 88.84% agreed with the mean value of 4.64 and the std. deviation of 0.058. The finding concluded that poor recordkeeping due to lack of correct accounting record,lack of accounting knowledge and awareness, lack of well qualified accountant, lack of prepare bookkeeping and basic accounting procedure. This implies that poor financial record keeping are the major factors affecting the financial performances of SMEs.
- According to "**Inventory Management System"** the respondent gives their opinion

with the cumulative results at 79.07% agreed with the mean value of 4.00 and the std. deviation of 0.531.The finding concluded poor inventory management system due to lack of controlling and safeguarding physical inventory against theft and misses, lack of owners experience to determine the level of inventory, lack of implementing Periodic and perpetual Inventory procedure to count inventory system. This implies that poor inventory management system apply in SMEs are affect the financial performances of SMEs.

Regression, Correlation Analysis and Hypothesis testing

The correlation analysis describes the correlation of each variable with other variables including dependent variable. Correlation value of -1 represents complete negative relationship while +1 represents a perfect relationship between variable. Correlation Matrix for SME Financial performance (SMEFP), Financial Reporting Practice (FRP), Financial Management practice (FMP), Financial Recordkeeping (FSP) and Inventory Management System (IMS).

Table4.2. *Correlation Matrix for SME Financial performance*

Correlation						
		SMEFP	FRP	FMP	FRK	IMS
Pearson Correlation	SMEFP	1.000				
	FRP	.669**	1.000			
	FMP	.625**	.726**	1.000		
	FRK	.644**	.470**	.659**	1.000	
	IMS	.547**	.696**	.545**	.409**	1.000

Source: SPSS result of the own survey 2020

Note: Sig. (2-tailed) *P<0.01, **P<0.10, *N= sample size of 92

Correlation Analysis for financial reporting practices

According to table 4.4 above; Pearson Correlation for financial reporting practices is 0.669 it suggested that there is positive and significant relationship between financial reporting practices and financial performance of SME's. The correlation coefficient is 0.000, statistically significant at 5% of significant level to 95% confidence interval. Thus, this study was accepted the alternative Hypothesis (H1A) and rejected the null hypothesis because the finding stated that there is a significant relationship between financial reporting practices and financial performance of SMEs. This study was supported by Muinde, C. (2013) he found that there is positive and significant relationship between financial reporting practices and financial performance of SMEs. Thus, the null hypothesis can be rejected and alternative hypothesis has to be accepted.

Correlation Analysis for Financial Management Practices

Based on the above table; Pearson Correlation for financial management practices is 0.625 it suggested that there is positive and significant relationship between financial management practices and financial performance of SME's. The correlation coefficient is 0.000, statistically significant at 5% of significant level to 95% confidence interval. Thus, this study was accepted the alternative Hypothesis (H2A) and rejected the null hypothesis (H2) because the finding stated that there is a significant relationship between financial management practices and financial performance of SMEs. This study was supported by Muinde, C. (2013) he found that there is positive and significant relationship between financial management practices and financial performance of SMEs. Thus, the null hypothesis can be rejected and alternative hypothesis has to be accepted.

Correlation Analysis for Financial Recordkeeping

The Pearson Correlation between financial recordkeeping and financial performance is 0.644 it shows that there is positive and significant relationship between financial recordkeeping and financial performance of SME's. The correlation coefficient is 0.000, statistically significant at 5% of significant level to 95% confidence interval. Thus, this study was accepted the alternative Hypothesis (H3A) and rejected the null hypothesis (H3) because the finding stated that there is a significant relationship between financial recordkeeping and financial performance of SMEs.

Correlation Analysis for Inventory Management system

According above to table, the Correlation between inventory management system and financial performance is 0.547. The finding states that there is a positive relationship between inventory management system and financial performance of SMEs. The correlation coefficient .000 is statistically significant at 5% of significant level with 95% confidence interval. This implies that the alternative hypothesis (H4A) is accepted and null hypothesis (H4) can be rejected, because the finding stated that there is a significant relationship between inventory management system and financial performance of SMEs. This study can be contradict the pre researcher idea study conducted by Muinde, C. (2013) he concluded that Inventory management practices are negatively correlation between financial performances of SMEs and thus the null hypothesis are accepted and the alternative hypothesis can be rejected.

Model Summary

Table4.3. *Multiple Regressions of Independent Variables and Dependent Variable (SFP)*

Model Summary[b]										
Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**	**Change Statistics**					**Durbin-Watson**
					R Square Change	**F Change**	**df1**	**df2**	**Sig. F Change**	
1	.897[a]	.766	.764	.15456	.766	311.761	5	87	.000	2.135
a. Predictors: (Constant), FRP, FMP, FRK, IMS.										

b. Dependent Variable: SFP, Source: SPSS result of the own survey 2020

In table 4.3, the coefficient of correlation **(R)** of the variables as a whole, fitness of the model **(R^2)**, adjusted R Square **(adj.R^2)** and standard error of the estimate were computed using SPSS 20.0 software and these were interpreted here.

In the column labeled R (correlation coefficient) were the values of the multiple correlation coefficients between the predictor and the outcome. When the four-predictor variables were used at once, the correlation between the independent and dependent variables were 0.897. The correlation coefficients lies with a values between -1(perfect negative correlation) to +1(perfect positive correlation) this shows us there was a strong correlation between the dependent and the independent variables.

The next column gives us a value of **R^2**(coefficient of determination) or fitness of the model , which was a measure of how much the variability in the outcome was accounted for by the predictors or the percentage of the dependent variable explained by the independent variables. Therefore, the value was .766, which means that financial reporting practice, financial management practice, financial Recordkeeping and inventory management system for 78.6% of the variance in financial performance of SMEs.

The adjusted R^2 gives an idea of how well the model generalizes and ideally it would be good its value to be the same, or very close to, the value of R^2 here the difference for the final model was a fair bit (0.766- 0.764=0.002 0r 0.2%). This shrinkage means that if the model were derived from the population rather than a sample it would account for approximately 0.2% less variance in the outcome.

Analysis of Variance

Table4.4. *Significant of Independent Variables on Dependent Variable (Customer Loyalty)*

ANOVA[a]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	38.479	5	6.898	311.118	.000[b]
	Residual	5.604	87	.031		
	Total	44.083	92			

Dependent Variable: SFP, Source: SPSS result of the own survey 2020

Based on the above table 4.4, By looking at the F-statistics and corresponding probability(P) value it can be used as a proxy for checking overall model significance. In this model F-value is 311.118 and corresponding probability value is 0.000 which is less than 5% level of significance as indicated by sign < 000. Therefore, the study models significantly more variance in financial performance of SMEs. The study has established variables of FRP, FMP, FRK and IMS are factors that influence to financial performance of SMEs. Significance of the study means that the regression model was also significant and therefore fit for the study.

Coefficients of Regression Model

Result of regression model on the impacts of Financial Reporting Practices, financial management practices, financial recordkeeping and inventory management system on Financial Performance of SMEs in Gamo Zone Arba Minch Town.

Table4.5. *T-Test and Beta Coefficients of the Independent Variables*

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.829	.093		8.342	.000
	FRP	.436	.042	.565	7.553	.000
	FMP	.419	.021	.489	5.374	.000
	FRK	.509	.021	.567	5.192	.000
	IMS	.398	.028	.495	4.604	.000

Dependent Variable: SMEFP, Source: SPSS result of the own survey 2020

Model Summary

Based on the coefficient values in the table 5, the regression equation of the financial performance can be constructed as follows;

SMEFP=0.829+0.436 FRP+ 0.419 FMP + 0.509 FRK + 0.398 IMS+0.093

Where, ***SMEFP*** = Financial performance of SMEs which is measured by the return on assets and net profits of the firm.***FRP***= Financial Reporting Practices ***FMP***= Financial Management Practices ***FRK***= Financial Recordkeeping **IMS**= Inventory management System *ε*= error term

According to the above stated equation when financial reporting practices, financial management practices, financial recordkeeping and inventory management system are zero the significant level of financial performance is 0.829 which means that there are other factors having an influence on the financial performance of SMEs. When one unit increase in financial reporting practices would lead to increase 43.6% of financial performance of SMEs, when a one unit increase in financial management practices it leads to increase in amount of financial performance by 41.9% units. On the other hand one unit increase in financial recordkeeping it leads to increase in amount of financial performance by 50.9% unit. Finally, increase in inventory management system would lead to increase in financial performance of SMEs by a unit of 39.8%. In generally, the finding shows that, all independent variable are positive or significantly affect the financial performance of SMEs in Gamo Zone Arba Minch Town.

CONCLUSION

This study has summarize the Descriptive Statistics of Variables, Correlation and Regression result provide the relevant explanations with statistical data and the study found that there is a significant relationship between reporting practices, management practices, analysis practices and inventory management practices and financial performance of SMEs.

Descriptive Statistics Result

In Ethiopia the SMEs are hampered by several factors, which may differ from region to region within the country. However, there are certain factors that are common to almost all SMEs. These factors arise from the financial reporting, management, recordkeeping and inventory management factors. The results reflected in the study indicate that financial report couldn't to address the current needs of the users, report does not contain description and variation of the potential needs of users, reports can not satisfied potential needs of external users for the last three years, financial reports are not free from errors for the last three years, reports are not complete with format while submitted to decision makers and measurement errors, monthly and annual financial reports are not submitted within due date, Lack of adequate financial planning, Inadequate uses and acquisition of funds, Taking poor financial decision, Poor financial controlling device such as budgetary control, ratio analyses and cost volume profit analyses, Lack of correct accounting record, Lack of accounting knowledge and awareness, Lack of well qualified accountant, Lack of prepare bookkeeping and basic accounting procedure, Lack of controlling and safeguarding Physical inventory against theft and misses, Lack of owners experience to determine the level of inventory, Lack of implementing Periodic and perpetual Inventory procedure to count inventory system were the mean indictors for the occurrences of poor inventory management system. Therefore, the above factors are cases for poor financial reporting practice, poor management practice, poor recordkeeping and inadequate inventory management system in SMEs are the major factors affecting the financial performances of SMEs in Ethiopia specially Gamo Zone, Arba Minch Towm.

Correlation and Regression result

The study has concluded that there is a significant relationship between financial reporting practices, financial management practices, financial recordkeeping and inventory management system and financial performance of SMEs in Gamo Zone, Arba Minch Town.

- Pearson Correlation for financial reporting practices is 0.669 it suggested that there is positive and significant relationship between financial reporting practices and financial performance of SME's. The correlation coefficient is 0.000, statistically significant at 5% of significant level to 95% confidence interval. Thus, this study was accepted the alternative Hypothesis (H1A) and rejected the null hypothesis.
- Pearson Correlation for financial management practices is 0.625 it suggested that there is positive and significant relationship between financial management practices and financial performance of SME's. The correlation coefficient is 0.000, statistically significant at 5% of significant level to 95% confidence interval. Thus, this study was accepted the alternative Hypothesis (H2A) and rejected the null hypothesis (H2).
- Pearson Correlation between financial recordkeeping and financial performance is 0.644 it shows that there is positive and significant relationship between financial recordkeeping and financial performance of SME's. The correlation coefficient is 0.000, statistically significant at 5% of significant level to 95% confidence interval. Thus, this study was accepted the alternative Hypothesis (H3A) and rejected the null hypothesis (H3).
- Correlation between inventory management system and financial performance is 0.547. The finding states that there is a positive relationship between inventory management system and financial performance of SMEs. The correlation coefficient .000 is statistically significant at 5% of significant level with 95% confidence interval. This implies that the alternative hypothesis (H4A) is accepted and null hypothesis (H4) can be rejected.

RECOMMENDATION

Based on the findings and conclusions of the research, this study has recommended certain points what the researcher thought to be very critical if accordingly and properly considered and implemented by the responsible stakeholders; SMEs supervisor, Owner of SMEs, Government bodies and future researchers. Accordingly, based on the findings of the study the following recommendations were forwarded.

For SMEs Supervisor

As per the result of this study, SMEs are weak relating to their overall financial reporting, financial management and recordkeeping and inventory management system. Therefore, this study recommended that individuals who supervising SMEs are advised that to upgrade their knowledge of financial management and reporting by giving more attention on those variables to improve the financial performance of SMEs.

For SMEs Owner

From the results of this study the owners of small and medium enterprises can easily understand how the efficiency and effectiveness use of financial management practice affected SMEs performance. As the result showed the weakness of their planning, acquisition of fund, financing decisions and poor financial controlling device, this study recommended that the owner of SMEs should be upgrade their knowledge of how they run business activities or recruiting qualified manpower to manage investment activities. In addition to this they should attention on how to improve the recordkeeping and accounting systems of their enterprises because for small enterprises, which often do not have a separate accounting or bookkeeping, the financial statements and records can provide some information for owners and managers in order to keep financial control over their businesses.

For Government Bodies

According to this study result, SMEs are weak regarding to overall financial management practices, recordkeeping and inventory management. Even though, Ethiopian government tried to solve external factors by provide a chances to get access to finance, technology, marketing areas and necessary infrastructure as much as possible, most of SMEs are failed to upgrade themselves to be large companies. This implies that governments and other potential donors are overlooked to prepare and giving sufficient training to SMEs how they manage their financial resources efficiently and effectively and prepare financial report. Therefore, the researcher recommends that government should be trying to search training access to small and medium enterprises to improve their ability of economies of scale because it is very important issue to be profitability because of SMEs are very weak in their financial resource utilization, inventory control and financial record keeping due to lack of well qualified human resources in the area of business.

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