# THE INFLUENCE OF FINANCIAL MONITORING ON PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES

## A CASE OF ARUSHA CITY COUNCIL

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**ABSTRACT**

*The study examined the influence of financial monitoring on the performance of SMEs in Tanzania. The study was guided by resource based and constructive learning theory. Descriptive survey research design and mixed research approached were used in this study. Data were collected from a sample of 204 SMEs using structured questionnaire and interviews. Descriptive and regression analysis was done on quantitative data while content analysis was done on qualitative data. Findings indicated that there were some challenges among respondents regarding financial monitoring since majority of business owners had inadequate financial knowledge. However, the study found that the performance of SMEs was realized through increase of sales volume, increase of profit, and increase of number of customers. The study recommended that Financial Institutions, the Ministry responsible and other stakeholders to equip SMEs with adequate financial skills in order to boost the performance of their business. Moreover, the study recommended that the Ministry responsible should design SME policies by identifying financial monitoring features which lead to desirable outcomes in SMEs performance.*

***Key terms: Financial Monitoring, Small and Medium Enterprises, Performance***

# Introduction

Small and Medium-Sized Enterprises (SMEs) account for two-thirds of all jobs worldwide (Worokinasih & Potipiroon, 2019). However, in developing and emerging economies, SMEs are far less productive than larger firms and provide inferior working conditions (Koirala, 2019). Due to lower productivity and the inability to meet international product standards, SMEs struggle to deliver the required product quantities at consistent quality and are less likely to export (Dev and Sengupta, 2020). Its mismatch performance is said to be related to both internal and external factors worldwide (Cooke, 2018).

According to Obi, et al, (2018), small and medium enterprises are significant driver of economic development, especially in transition economies in many developing countries. For example, in East Africa, the value of goods and services created or generated by small and medium enterprises was USD 1,363,733 million of the total USD 2,360,157 million; thus, a contribution of 58%. They employed 2,704,127 people, representing 56% of employment size in 2017. But still SMEs development in the country is shocking since they are not jumping to growth business level as reported by Suleiman (2018) and Adomako et al, (2020). Despite of this significance, Dev and Sengupta, (2020), indicated that SMEs performance is affected by number of factors including inaccessibility to financial services, poor infrastructures, a poorly coordinated institutional support framework, poor business development services, lack of entrepreneurial skills, lack of internal control which defined as monitoring tools and lack of opportunities to explore the external markets. The outcome and improvement of all these factors is highly affected by how the financial matters of a firm are monitored (Kitonyi et al.,2020).

Financial monitoring as a systematic process of collecting, analyzing and using financial information to track a programme's progress toward reaching its objectives and to guide management decisions is a key for SMEs performance (Belas, 2019). According to Nastasiea and Mironeasa (2019), when monitoring is used among SMEs, they will be in a position to know when and where activities occur, who delivers them and how many people or entities they reach. This is the reason why monitoring is sometimes referred to as process, performance or formative evaluation. Worokinasih and Potipiroon (2019) pointed out that monitoring help the SMEs in determining whether all business activities are carried out properly in time and bring the expected benefits.

SMEs performance is a target of all who are involved on it since it is shows the outcomes of business activities. SMEs performance can be measured using various indicators that have been used in past studies; these are growth in sales, employees, profit, assets, and equity (Razak, Abdullah & Ersoy, 2018). Ibidunni, et al, (2020) on the other hand has it that understanding SMEs performance is vital especially in the current context of rapid changes in the world economy where the interdependencies between national economies and a difficult recovery after the global economic crisis have meant that the role of SMEs has significantly increased, based on their ability to adapt to challenges of a continuously changing environment.

Worldwide, various studies about the influence of monitoring towards SMEs performance have been conducted. For instance, in the United States of America, SMEs are expected to contribute to the GDP by 65% since the industry is providing approximately 75 percent of the net jobs added to the economy and represent 99.7 percent of all employers (Dhika *et al*, 2020). The study further revealed that apart from other factors for SMEs performance, the issue of monitoring play a key role. In Malaysia, Surienty (2018) found that SMEs who had financial skills and monitor their businesses witnessed the tremendous performance of their business. This is because SMEs have adequate information on all the activities taking place in their business.

In their recent study in South West, Nigeria, Asikhia and Naidoo (2020) reported a significant difference in the evaluations of management success determinants to performance and management skills of the SMEs operators, monitoring, organization structure and innovation as being the most critical success factors for the SMEs in the Nigerian business environment. It was argued from the study that SMEs should be given awareness on monitoring as a key to business performance. Govuzela and Mafini (2019) realized that SMEs in South have access to financial assistance from various institutions but the majority lack business skills including monitoring of their business. This has affected the performance of many SMEs.

In Kenya, Kitonyi et al., (2020) showed despite of some challenges, the SME sector is performing well because of the SMEs' monitoring. Many financial institutions in the country have been initiating strategies to equip SMEs with monitoring skills through various seminars and group meetings. This has improved the SMEs performance.

Nastasiea and Mironeasa (2019) agreed that financial and correspondence performances are among of the monitoring types that have great impact to business performance and growth among SMEs especially in developing countries. The study mentioned inadequate business education as one of the cause for SMEs to fail monitoring their business in terms of financial and correspondence. In Tanzania 95% of the businesses are small and Medium Enterprises (SMEs) and they represent about 35% of the country's GDP, (TCCIA, 2021). According to Nkwabi and Mboya, (2019), because of its importance, the government of Tanzania has made various efforts to promote SMEs performance such as the establishment of Small Industries Development Organization (SIDO) and Small and Medium Enterprises (SMEs) policies.

Kiyabo and Isaga (2019) added that in September, 20216 the government launched the establishment of Tanzania Entrepreneurship and Competitiveness Centre (TECC) to promote entrepreneurial innovation and competitiveness in the country. Also, various measures have been taken by the Local Government Authorities (LGAs) including strengthening of business council meetings, survey and allocation of land for investment done in all LGAs, sensitize LGAs to use the youth and women empowerment fund to support the establishment of SMEs. Despite the initiatives done by the government of Tanzania as cited by Kiyabo and Isaga (2019) as well as Nkwabi and Mboya, (2019), the SMEs performance is not satisfactory. From this context, this study was conducted to see the influence of financial monitoring on the performance of SMEs.

In the context of Arusha region where the study was conducted as the hub of tourism with many numbers of SMEs with the collaboration with the government has been trying to develop the sector by implementing various strategies including searching markets for products, provision of credits, and funding. Small and medium enterprises are expected to break even towards repaying their capital invested for the improved welfare of their owners also SMEs in Tanzania play a crucial role in the development of our economy and carry a large share of the GDP (Naegels, 2020), So toward achieving SMEs performance, it was essential to examine the influence of financial monitoring on the performance of SMEs.

On the other hand, the OECD (2018) report on monitoring and evaluation of SME and entrepreneurship programmes indicated that reliable methods for the monitoring and evaluation are not well applied among SMEs which affect their entrepreneurial growth. From these literatures, it was found that various studied was conducted on the influence of monitoring on the performance of SMEs. Therefore, this study was unique as it focused only on the influence of financial monitoring on the performance of SMEs in Arusha city council.

## Literature Review

### 2.1 Theoretical Review

### Resource based theory

The resource- based theory of the firm propounded by Wernerfelt, (1984) and regarded as one of the theories of strategic management, the aim was to examines performance differences of organizations or SMEs based on their resources under two assumptions whereby organizations within an industry may differ in their resources and these resources may not be perfectly mobile across organizations, so organizational differences in resources can be very long lasting (Barney, 1991). The theory seeks to explain how organizations or SMEs maintain unique and sustainable positions in competitive environments since it focuses on efficiency-based differences, instead of on other ways in which organizations could be different, such as market power, collusion, or strategic behaviors (Peteraf & Barney, 2003). The central idea in resource-based theory is that organizations or SMEs compete against others on the basis of their resources and capabilities in which SMEs or organization's competitors can be identified by the similarity of their products, resources, capabilities, and substitutes.

Linking to this study organization represented as SMEs in which to gain competitive advantage in competitive business environment, SMEs need to design and use profitable, value-creating strategy which is termed as monitoring tools to monitor SMEs resources which includes financials reports, employee behavior and funds as the key factor to be tracked for SMEs performance. Therefore, the theory related to the study since the study associated financial monitoring as one of the key monitoring tool with the performance of SMEs in Arusha City Council.

### 2.2 Empirical Literature Review

Musah, Gakpetor and Pomaa (2018) conducted a study on financial management practices, firm growth and profitability of small and medium scale enterprises (SMEs). Descriptive statistics revealed that working capital management practices had the highest mean score, followed by accounting information and financial reporting practices, capital structure management and finally, the use of capital budgeting techniques and fixed assets management, in that order. The Pearson correlation analysis showed a positive association between the four components of financial management practices and between SMEs profitability and growth. The results emphasize the need for SMEs to improve on their financial management practice to improve the profitability and growth of these firms. The study focused on financial management practices, firm growth and profitability of small and medium scale enterprises (SMEs). The current study will bring a new concept of monitoring and how it influences SMEs performance in terms of sales volume and profit.

A study supported by Ngirande (2016) studied the perceived barriers to the development of small, medium and microenterprises: A case study of Thulamela Municipality in the Limpopo Province. The study revealed that, indeed, SMMEs in Thulamela Municipality in the Limpopo Province of South Africa are faced with various barriers affecting their development. Five significant barriers were identified, namely, lack of finance, access to market, out- dated equipment and technology, poor infrastructure and lack of training. The study focused on barriers to the development of SMEs, also the study was conducted in Limpopo Province of South Africa. A purposive sample of seventy-five SMME owners and managers participated in this study. This study will narrow by examining the how monitoring influence performance of SMEs in Tanzania.

Another study conducted by Robert Odek, Elmad Okoth (2019) on the effect of internal control systems on financial performance of distribution companies in Kenya showed that that internal control systems are important management tools in financial management in which lack of it lead to declining profitability trends among Small and Medium scale Enterprises despite government's commitment to availability of funds to SMEs, hence the study indicate that the interaction between internal control systems as the independent variable and financial performance as the dependent variable to add to the existing knowledge bank regarding book keeping, internal controls and financial performance among small and medium sized enterprises in Kenya. The study focused on financial monitoring among SMEs in Kenya which is only one aspect among of the four aspects (operational, financial, employee's behavior and correspondence) to be covered in the current study.

Muneer, Ahmad and Ali (2017) studied the impact of financial management practices on SMEs profitability with moderating role of agency cost in Pakistan. The findings of this study indicate the presence of positive relationship between financial management practices and SMEs profitability but agency cost as a moderator has no effect on this relationship. The study strongly recommends higher adherence to financial management practices. Policy makers, developments partners, owners, and managers of SMEs may use these findings for sustainability of their business in Pakistan. Like Robert Odek, Elmad Okoth (2019), this study focused on financial management practice on SMEs profitability. The current study will go beyond that by examining the influence of monitoring (operational, financial, employee's behavior and correspondence) on SMEs performance not only in terms of profit but also sales volume.

Furthermore, Gawali and Gadekar (2017) in their study on financial management practices in micro, small and medium enterprises-an exploratory analysis with the help of literature review indicated the significance of better financial management decisions on the basis of efficient financial management practices which are critical and crucial for the survival, growth and profitability of MSMEs. The study concluded that accounting and financial knowledge, competencies in interpreting the financial statements, owner-managers attitudes and their level of involvement in financial aspects of business largely responsible for the success or failure of MSMEs. Despite the fact that the study has indicated key issues on financial management among SMEs, the study was exploratory as it based on literature review.

This study examined the influence of financial monitoring on the performance of SMEs. SMEs performance was measured through increased sales volume, increase of profit, and increased number of customers.

## Research Methodology

The study employed mixed method approach in which the qualitative data enabled the clarification of the quantitative data which could not be captured by use of structured questionnaire. The data collected was analysed quantitatively using descriptive statistics using STATA and Microsoft excel analytical tool while qualitative data were analyzed through content analysis. Data were collected from a sample of 204 SMEs.

**RESULTS**

A total of 204 questionnaires were distributed and 188 (92.1%) were filled and returned. Analysis of interview data was done through content analysis based on themes derived from research objective. Under descriptive analysis respondents were to respond by ticking most appropriate option ranging from 1 - strongly disagree, 2 - disagree, 3 - Agree and 4 - strongly Agree. Scale of mean score interpretation was as follows: 3.50-4.00 = strongly agree, 2.50-3.49= agree, 1.50-2.49 = disagree, 1.00-1.49 = strongly disagree as indicated by Chyung, et al, (2017). Findings from deceptive analysis are presented in table 1.

**Table 1: Perception of respondents on the influence of financial monitoring on the performance of SMEs**

| SN | Item | Mean | Std. Dev | Interpretation |
|---|---|---|---|---|
| 1. | We are responsible for managing the business's finances | 3.89 | .57656 | Strongly Agree |
| 2. | We make financial monitoring on weekly bases | 3.08 | .63694 | Agree |
| 3. | We make financial monitoring monthly/quarterly | 3.21 | .60850 | Agree |
| 4. | We make financial monitoring annually | 2.95 | .76805 | Agree |
| 5. | We have adequate knowledge of financial monitoring | 1.86 | .71857 | Disagree |
| 6. | We use my expert for financial monitoring | 1.37 | .94832 | Strongly Disagree |
| 7. | Financial monitoring has improved | 2.63 | .83625 | Agree |

**Source:** Field Data (2022)

As reflected in table 1, respondents had varying views on whether or not financial monitoring influenced performance of SMEs. Specifically, the study indicated that respondents strongly agreed that they were responsible for managing the business's finances with the mean score of 3.89. This means as business owners, they saw that it is their key responsibility to manage the finances in their business. Moreover, findings indicated that respondents agreed that their business performance were influenced by financial monitoring as they were making financial monitoring on weekly bases, monthly/quarterly and annually with the mean score of 3.08, 3.21 and 2.95 respectively. This implies that weekly, monthly and annual financial monitoring was conducted depending on the type of business. Respondents further agreed that their financial performance was improved with the mean score of 2.63.

Findings also revealed that respondents disagreed that they had adequate knowledge of financial monitoring and strongly disagreed that they use expert for financial monitoring with the mean score of 1.37 and 2.63 respectively. The findings give an expression that many business owners have no adequate knowledge on financial monitoring which can affect their business performance. Similarly, findings imply that to use experts in financial monitoring was not affordable to the majority of respondents.

Through the interviews, it was established that financial monitoring is done through keeping proper records for sales using ledger books. Also it was established that cash was kept through banks and mobile phone accounts. Moreover, financial management skills is acquired through different MFIs. Financial monitoring is done regularly to detect losses in business

The findings imply that SMEs were aware on how they then can boost their business performance in terms of sales volume and profit through various ways as shown in table 1. This gives a conclusion that financial monitoring was essential in SMEs business performance in terms of sales and profit in the study area.

**Table 2: Perception of respondents on SMEs Performance**

| SN | Item | Mean | Std. Dev | Interpretation |
|---|---|---|---|---|
| 1. | There is an increase of sales volume | 3.07 | .62917 | Agree |
| 2. | There is an increase of profit | 2.63 | .83765 | Agree |
| 3. | There is an increase of product line | 3.22 | .74123 | Agree |
| 4. | There is an increase of number of customers | 2.85 | .86481 | Agree |
| 5. | There is an increase of sales in other regions | 3.04 | .70642 | Agree |
| 6. | There is performance of business | 2.56 | .95724 | Agree |

**Source:** Field Data (2022)

Findings about SMEs Performance as presented in table 2 indicated that respondents agreed with all items. Specifically, they agreed that there is an increase of sales volume, increase of profit, increase of product line, increase of number of customers, increase of sales in other regions, increase of sales in other regions and that there is performance of business. This is evidence that there was performance among SMEs.

**Regression Analysis**

A multiple regression model was used to examine the relationship between financial monitoring, as independent variable and SMEs performance as a dependent variable.

$Y = \beta0 + \beta1\ X1 + e$ (2)

Where;

Y = SMEs performance

X1 = Financial monitoring

e = Error term.

βii = 1 - 2 used to measure the sensitivity of the dependent variable (Y) to unit change in the predictor variables X1, ε is the error term which captures the unexplained variation in the model. Therefore, the study used multiple regression model because it enabled to determine the strength of relationship between financial monitoring as independent variable and SMEs performance as a dependent variable as shown in table 3.

**Table 3**: Coefficients for the regression model

| **Regression Analysis** | | | | | |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | t. | Sig. |
| (Constant) | 3.036 | .371 | | 7.462 | .000 |
| Financial monitoring | -.378 | .100 | -.228 | 2.672 . | .000 |

The model summary for the above correlations revealed that all the independent variable is statistically significant: Financial monitoring (p-value = .000). Therefore, when evaluating the standardized beta values, the greatest influences upon the dependent variable is financial monitoring (beta = -.228). These findings gives an expression that there is a relationship between financial monitoring and performance of SMEs in Tanzania.

## DISCUSSION

Findings about the influence of financial monitoring on the performance of SMEs are supported by previous studied like Musah, Gakpetor and Pomaa (2018) who conducted a study on financial management practices, firm growth and profitability of small and medium scale enterprises (SMEs). The results emphasize the need for SMEs to improve on their financial management practice to improve the profitability and growth of these firms.

Another study conducted by Robert Odek, Elmad Okoth (2019) on the effect of internal control systems on financial performance of distribution companies in Kenya showed that that internal control systems are important management tools in financial management in which lack of it lead to declining profitability trends among Small and Medium scale Enterprises despite government's commitment to availability of funds to SMEs, hence the study indicate that the interaction between internal control systems as the independent variable and financial performance as the dependent variable to add to the existing knowledge bank regarding book keeping, internal controls and financial performance among small and medium sized enterprises in Kenya.

Furthermore, Gawali and Gadekar (2017) in their study on financial management practices in micro, small and medium enterprises-an exploratory analysis with the help of literature review indicated the significance of better financial management decisions on the basis of efficient financial management practices which are critical and crucial for the survival, growth and profitability of MSMEs. The study concludes that accounting and financial knowledge, competencies in interpreting the financial statements, owner-managers attitudes and their level of involvement in financial aspects of business largely responsible for the success or failure of MSMEs

## CONCLUSIONS

The study concluded that financial monitoring was the key factor in influencing SMEs performance in Arusha City Council. The study further concluded that there were some challenges among respondents regarding financial monitoring since majority of business owners had inadequate financial knowledge. It was also concluded that the performance of SMEs was realized through increase of sales volume, increase of profit, and increase of number of customers.

## RECOMMENDATIONS

The study recommended that Financial Institutions, the Ministry responsible and other stakeholders to equip SMEs with adequate financial skills in order to boost the performance of their business. Moreover, the study recommended that the Ministry responsible should design SME policies by identifying financial monitoring features which lead to desirable outcomes in SMEs performance.

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