FINANCIAL MANAGEMENT PRACTICES AND FINANCIAL PERFORMANCE OF SMALL AND MEDIUM-SIZE ENTERPRISES IN SRI LANKA: SPECIAL REFERENCE TO UVA PROVINCE

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ABSTRACT

Financial management is a crucial factor that determine the financial performance. The Small and Medium-sized Enterprises (SMEs) are small in nature therefore; it faces challenges to adopt proper financial management practices to enhance profitability. This study investigates how financial management practices influence the financial performance of SMEs in Uva Province, Sri Lanka. The study explores critical dimensions of financial management such as working capital management, financial reporting and analysis, accounting information systems, investment appraisal, and financing. A sample of 500 SMEs was selected and data were gathered using a self-administered questionnaire. Descriptive statistics, Pearson correlation, and multiple regression analysis were utilized to examine the data, with Cronbach's Alpha confirming the reliability of the measurement instruments. The results reveal significant positive correlations between effective financial management practices and the financial performance of SMEs. Specifically, improvements in Working Capital Management, Financial Reporting, Accounting Information Systems, Investment Appraisal, and Financing are linked to better financial outcomes. The regression analysis indicates that these practices collectively exert a substantial influence on financial performance, with the model exhibiting a strong predictive fit. These findings highlight the vital role of effective financial management in improving SME performance and success.

Keywords: ***Financial Management Practices, Performance, SMEs, Sri Lanka***

1. INTRODUCTION

Small and medium-sized enterprises (SMEs) are widely recognized as the backbone of an economy, contributing significantly to job creation, poverty reduction, economic empowerment, and export growth (Deyshappriya and Maduwanthi, 2020). In Sri Lanka, SMEs serve as a key driver of economic growth, playing a crucial role

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in employment generation, fostering innovation, and supporting regional development which are essential factors for long-term economic sustainability (Rathnasiri, 2014). The National Policy Framework for SME Development highlights their economic impact, noting that SMEs comprise over 75% of all enterprises, provide 45% of employment, and contribute 52% to the country's Gross Domestic Product (GDP).

Financial management is a critical capability that all organizations must enhance to ensure long-term success and sustainable growth. It involves obtaining and allocating financial resources, raising the capital needed to support an enterprise's assets and operations, balancing the distribution of that capital among competing needs, and ensuring that resources are used efficiently and effectively to benefit the organization (McMahon et al., 1993). Therefore, the survival and prosperity of a business are heavily dependent on sound financial management (Rathnasiri, 2014).

SMEs frequently encounter significant challenges in accounting and financial management, primarily due to poor record-keeping, inefficient use of accounting information in decision-making, and unreliable financial data (Balagobei, 2020). Effective financial management, encompassing planning, organization, control, and resource utilization, is particularly crucial for SMEs, given their limited assets and vulnerability to market uncertainties (Nkwinika and Akinola, 2023). In Sri Lanka, SMEs struggle to access financing for growth and development (Central Bank of Sri Lanka, 2021). Moreover, their financial management practices differ from those of larger firms due to unique cash flow cycles, working capital constraints, and difficulties in securing external financing through debt and equity (Kengatharan, 2020).

Researchers suggest that many SMEs lack the robust financial management and accounting systems that large companies utilize, as well as the experienced personnel necessary to manage these functions effectively (Muneer et al., 2017; Turyahebwa et al., 2013). The majority, 60%, of SMEs fail within their first few months of operation (Karadag, 2015; Matsoso and Benedict, 2014; and Ahmad and Arif, 2015) due to inadequate or non-existent bookkeeping and accounting practices, which are crucial elements of effective financial management (Bowen et al., 2009; Germain, 2010; Kitonga, 2013).

Several studies on SMEs in Sri Lanka have highlighted the critical role of financial management practices in enhancing financial performance (Sooriyakumaran, Thrikawala and Chandrapala, 2022; Somathilake and Pathirawasam, 2020; Tharmini and Lakshan, 2021; Sandaruwandi, Panditharathna and Rathnayake, 2023). However, these studies were conducted before or during the COVID-19 pandemic and the economic crisis, necessitating a reassessment in the current context. Research on SME financial management practices in the Uva Province remains limited, despite its importance. This study aims to fill this gap by analyzing the financial management practices and performance of SMEs in the region.

2. LITERATURE REVIEW

Defining SMEs is challenging due to the absence of a universally agreed-upon definition and the inconsistency of available data. Consequently, different countries, and even different regions and institutions within the same country, interpret the concept of SMEs in various ways. Sri Lanka's National Policy Framework for SME Development defines SMEs as businesses with fewer than 300 employees and an annual turnover not exceeding Rs.750 million. In this context, micro-enterprises are also included alongside SMEs for policy-related purposes.

According to World Bank standards, any company with fewer than 99 employees qualifies as an SME. In contrast, the Industrial Development Board of Sri Lanka classifies a business as an SME if its capital investment in equipment and machinery does not exceed Rs.4 million. This variability in definitions underscores the complexity of categorizing SMEs across different contexts.

2.1. Theoretical Review

2.1.1. Pecking Order Theory

Pecking order theory, originating from behavioral economics and corporate finance, was initially proposed by Donaldson (1961) and later established by Myers and Majluf (1984). The theory explains how companies prioritize their financing choices, starting with internal funds before considering external options. When internal funds are insufficient, firms tend to favor debt financing over equity. Equity financing is viewed as the last resort. This hierarchical approach to funding is known as the "Pecking order," where firms move from internal funds to debt and, only, if necessary, to equity.

2.1.2. The Contingency Theory

Contingency theory posits that organizations operate as open systems, continuously interacting with and adapting to their external environment. Consequently, the characteristics and structure of an organization are shaped by various external factors such as the environment, market conditions, and the technology they adopt. Originating from organizational studies, contingency theory has evolved over time. As Chenhall (2003) noted, these factors influence the organizational structure, which, in turn, affects the architecture of the financial system. Achieving operational efficiency requires balancing the business environment with the financial system's functioning.

The theory emphasizes three corporate context elements that are believed to be closely related to the functionality and design of financial system components: capital budgeting control policies, the level of professional skills, and the historical outcomes of investments. The theory suggests that firms have unique accounting systems, leading to varied financial performances, as these systems are shaped by the specific context of each organization. Therefore, when allocating resources for financial management, these contextual factors should be taken into account.

The theoretical framework indicates that some financial management practices may be effective for certain businesses but not for others, due to differences in business environments and external influences. This implies that SMEs are not bound to a standard set of financial management practices. Instead, SMEs should choose financial management practices that align with their specific business environment to achieve their objectives. Only when there is harmony between the corporate environment and the operations of the financial system will SMEs experience a positive impact on their financial performance.

2.2. Financial Management Practices (FMP)

FMP involve the effective management and allocation of financial resources to maximize shareholder value and achieve organizational objectives (Sunday et al., 2021). Zietlow et al. (2007) define financial management as the process of creating value, controlling financial resources, enhancing profitability, and ensuring satisfactory level of returns for investors. Financial management practices encompass every aspect of an organization's financial operations and play a crucial role in achieving its overarching goals. Key components of financial management practices in businesses include managing current and non-current assets and liabilities, conducting financial reporting and analysis, and determining the optimal capital structure (Kitonga, 2013; Kilonzo and Ouma, 2015). Furthermore, effective financial management practices contribute significantly to the improved performance of SMEs (Somathilake and Pathirawasam, 2020). Therefore, the hypothesis is:

H_1: Financial management practices have a significant impact on the financial performance of SMEs.

2.2.1. Working Capital Management Practices (WCM)

The key objective of working capital management is to maintain an optimal balance, ensuring that working capital is neither excessive nor insufficient (Abimbola and Kolawole, 2017). In SMEs, WCM entails managing critical components such as cash, receivables, payables, and inventories, while implementing policies that ensure an appropriate level of investment in net working capital to support targeted revenue. Numerous studies have found that most SMEs lack formal WCM routines, leading to generally low levels of WCM practices (Muneria and Otinga, 2019; Agyei-Mensah, 2011). For instance, Turyahebwa et al. (2013) explored the management of cash, receivables, payables, and inventory, as well as the impact of WCM policies on profitability in manufacturing SMEs.

Czarnitzki and Hottenrott (2011), investigated the relationship between WCM and profitability of SMEs, after adjusting for unobservable variations. Their findings suggested that SMEs can boost profitability through effective management of working capital. Conversely, Masocha and Dzomonda (2016) revealed ineffective WCM practices among 50 selected SME owners in South Africa.

Charitou et al. (2010) examined the impact of WCM on the financial performance of companies in emerging markets, confirming that effective WCM leads to higher profitability. Kosgey and Njiru (2016) also identified a strong, positive correlation

between cash management and the financial performance of SMEs. Additionally, Nyamao et al. (2012) reported that poor WCM practices negatively impacted SMEs' financial performance. Corresponding studies by Hamza et al. (2015), Oluoch (2016) and Nyakundi et al. (2016) further affirmed that effective WCM significantly improves SME business performance.

In Sri Lanka, researchers such as Rathnasiri (2014), Somathilake and Pathirawasam (2020), and Yogendrarajah et al. (2017) have observed that WCM methods are not widely implemented in SMEs. Consequently, there appears to be no significant impact, whether positive or negative, on business performance. The literature of this study is informed by the inconsistent findings, particularly when WCM is considered as a variable within the broader context of financial management practices. Therefore, the hypothesis is:

H_{1a}: Working Capital Management practices have a significant impact on the financial performance of SMEs.

2.2.2. Financial Reporting Analysis Practices (FRA)

Financial reporting involves systematic procedures that provide stakeholders with official records detailing a company's financial status, including capital, cash flow, revenues, expenses, and profit, as defined by the financial reporting framework. Gitman et al. (2015), as cited in Adeyemi and Sajuyigbe (2017), emphasized that a company can only supply the necessary data for effective planning and decision-making if its financial reporting, recording, and accounting information systems align with its goals. Despite the importance of accurate financial reporting, SMEs often struggle with the creation and presentation of financial reports due to inadequate accounting systems, limited human resources, and insufficient record-keeping (Ezeagba, 2017). However, enhanced financial reporting can significantly improve SMEs' forecasting capabilities and foster more efficient management practices (Sooriyakumaran et al., 2022). Therefore, the hypothesis is:

H_{1b}: Financial reporting analysis practices have a significant impact on the financial performance of SMEs.

2.2.3. Accounting Information System (AIS)

Automating and streamlining reporting is one of the primary advantages of computer-based AIS. These systems enable organizations to generate timely, summarized information that can be used for financial reporting and decision-making (Romney et al., 2015). Research suggests that AIS positively impacts the performance of SMEs (Azize and Esmeray, 2013; Belal, 2013). However, despite the low adoption rate of AIS among SMEs (Abanis et al., 2013), findings on its performance effects are mixed. Somathilake and Pathirawasam (2020) argued that AIS did not significantly impact SME performance, while others (Al-Dalaien and Khan, 2018; Turyahebwa et al., 2013; Tharindi and Rathnayaka, 2016) demonstrated a significant positive influence of AIS on SME outcomes. This suggests that an effective AIS can enhance the financial performance of SMEs. In contrast, Uduwaka and Dedunu (2019) found no statistically significant relationship between AIS and SMEs' financial performance

in their study on financial management methods. Therefore, the hypothesis is:

H_{1c}: Accounting information systems have a significant impact on the financial performance of SMEs.

2.2.4. Investment Appraisal Practices (IAP)

Capital expenditures aimed at generating future returns are commonly referred to as investments (Wambua and Koori, 2018; Beal et al., 2005). Investment decisions typically involve four key factors: risk, irreversibility, significant initial costs, and a long-term horizon. The investment process generally consists of three stages: identifying potential opportunities, analyzing these opportunities, selecting the one that best aligns with shareholder value, and then implementing and monitoring the chosen investment (Somathilake and Pathirawasam, 2020). Consequently, decisions related to long-term assets and investments are critical in shaping an organization's overall success or failure (Jayawardane and Gamlath, 2020). Brigham (1995) further argued that capital budgeting is even more important for smaller firms, as they have limited access to public markets for funding compared to larger organizations. Therefore, the hypothesis is:

H_{1d}: Investment appraisal practices have a significant impact on the financial performance of SMEs.

2.2.5. Financing Practices (FIN)

SMEs prioritize maintaining a minimum cost of capital by carefully balancing equity and debt in their financing decisions (Bowen et al., 2009). Their focus is primarily on selecting an optimal financing mix to maximize value of the firm while addressing the interests of other stakeholders. In developing countries, effective management of cash flow risk is crucial for SMEs when making financing decisions (Karadag, 2015). Research shows a strong correlation, whether positive or negative, between financing mix and SME performance (Karanja, 2012; Chepkemoi, 2013). Specifically, the capital structure is a key determinant of SME performance in Sri Lanka (Somathilake and Pathirawasam, 2020). Therefore, the hypothesis is:

H_{1e}: Financing practices have a significant impact on the financial performance of SMEs.

2.3. Financial Performance in SMEs (FP)

Performance refers to how effectively an organization generates wealth and secures resources (Khan et al., 2014). It includes both financial returns and the broader benefits arising from its operations and business processes. Despite the strategies employed by owners and managers, many SMEs continue to face challenges in achieving strong financial performance. Poor financial management often leads to weak performance, which can result in business failure (Abe et al., 2015). Common indicators of SME performance include growth in sales, profits, and total assets (Chepkemoi, 2013; Nthenge and Ringera, 2017; Daniel and Japhet, 2017).

Febrianty (2017) argued that profit growth is the most critical factor in ensuring corporate sustainability. Companies experiencing rapid profit growth are more likely

to attract investors, as profits serve as a key indicator of performance. According to Ifada and Puspitasari (2016), there is a strong correlation between profit growth and financial performance. Financial policy is shaped by fluctuations in income, and a company with rising profits is considered to be performing well.

Sales growth can enhance an organization's productivity and efficiency. By analyzing high sales growth rates, companies can better forecast earnings and set profit targets, providing a clear direction for achieving their goals (Angelia et al., 2021). An increase in sales suggests that a business's products are well-received by customers and competitive in the market (Delmar et al., 2013). Research has shown that sales growth leads to improved performance in SMEs (Wangsih et al., 2021; Yeni et al., 2019).

Many studies have achieved a consensus on the significant role of cash flow statements in determining the liquidity and helping the management in their decisions in various aspects such as operating, financing and investing decisions (Collins et al., 2014; Zhang and Trafalis, 2013). Cash flows can help enhance the ability to compare performance reports for different projects since it eliminates the effects of using different accounting treatments for the same process. Cash flow plays a major role in providing loans and investments to officials with appropriate information that helps them make many economic decisions as well as providing information on the firm's operating activities (Khaled, 2012; Eyisi and Okpe, 2014). According to Turcas (2011), the firm's capacity to produce positive cash flows from its operating, investing, and financing operations determines its solvency, flexibility, and financial performance. Therefore, by reducing cash input and raising cash outflow, poor cash flow planning with reference to operating operations have a detrimental effect on the financial performance.

Operational processes contribute to the wealth of business owners by leveraging assets to generate profitable sales. Effective utilization of firm resources is crucial for achieving organizational objectives. Managing assets involves maintaining inventories, accounts receivable, fixed assets, and other resources in optimal condition to generate expected profits and increase owners' wealth (Rahayu, 2019). Osamor et al. (2021) noted that asset utilization is the efficient use of a firm's assets to maximize sales revenue and achieve sustainable profitability. It can be evaluated through various metrics, such as asset lifespan, current asset turnover, asset revaluation, and capital realization.

Asset utilization is a key metric and technique for assessing financial performance. One of the main challenges of asset utilization is evaluating the maximum returns generated from purchased assets over their economic lifespan and accurately reflecting the impact of these returns on a firm's financial position. Additionally, wear and tear on assets often result from poor maintenance (Akinleye and Dadepo, 2019). Improper asset management is a significant concern, as it affects liquidity, operational efficiency, profitability, and leverage. Osamor et al. (2021) argued that excessive spending on non-current assets and inadequate inventory management are key factors behind many organizations' failures in asset management and utilization.

3. METHODOLOGY

The study employed a quantitative research methodology to analyze statistical data related to key financial management practices. As there is no updated registry of SMEs in this province, a convenience sampling technique was used to select a sample of 500 SMEs. Data were collected from managers or owners using structured questionnaires, which were divided into two sections: demographic information and questions regarding financial management practices and performance. Financial management practices were assessed using a five-point Likert scale. Independent variables included Working Capital Management Practices (WCM), Financial Reporting and Analysis Practices (FRA), Accounting Information Systems (AIS), Investment Appraisal Practices (IAP), and Financing Practices (FIN). Financial performance, the dependent variable, was measured based on profit growth, sales growth, net cash flow increase, and asset utilization. Descriptive statistics, Cronbach's alpha reliability analysis, and correlation analysis were used for data analysis. Finally, this study employs a multiple regression analysis to evaluate the impact of financial management practices on the financial performance of SMEs. The regression model is specified as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon \quad (1)$$

Where:

Y = *Financial performance of SMEs (FP)*

β_0 = *Intercept of the regression model*

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ = *Coefficients representing the effect of each independent variable.*

$X_1 = Working\ Capital\ Management\ Practices\ (WCM)$

$X_2 = Financial\ Reporting\ and\ Analysis\ Practices\ (FRA)$

$X_3 = Accounting\ Information\ Systems\ (AIS)$

$X_4 = Investment\ Appraisal\ Practices\ (IAP)$

$X_5 = Financing\ Practices\ (FIN)$

$\epsilon = Error\ term\ accounting\ for\ unexplained\ variation$

The following table shows the operationalization and measurement of variables. The respondents were requested to select the most suitable answer from 5-point Likert scale questions, ranging from "Strongly Disagree" to "Strongly Agree".

Table 1: Operationalization and Measurement of Variables

Variables	Dimensions	Questionnaire items
Working Capital Management	Efficient management of working capital components	Maintain cash flow, maintain proper records, short-term financing need analysis, forecasting, inventory and account receivable management.
Financial reporting and analysis practices	Proper preparation of financial reports	Knowledge of report preparation, regular reports, transparency and proper analysis
Accounting Information System	Usage of AIS	Knowledge, usage of AIS, training on AIS, data security, and use of AIS for decision making.
Investment Appraisal Practices	Apply Investment Appraisal methods	Knowledge, applying suitable methods, consult with an external advisor, usage of model/software, and risk assessment.
Financing Practices	Capital structure components	Knowledge, of use different capital components, control risk, utilize the debt facilities, and anticipation of additional finance needs.
Financial Performance	Outcomes of business activities	Growth of sales, profit increase, achieving target profit, and overall satisfaction of the performance.

4. RESULTS AND DISCUSSION

4.1. Descriptive Statistics

A summary of demographic characteristics and business profile of respondents is given in the table 1 below;

Table 2: Demographic characteristics and business profile

Variable	Values	Percent
Gender	Male	98%
	Female	2%
Ownership	Sole proprietorship	67%
	Family- owned	33%
Age of the Respondents	Below 30 Years	5%
	30 – 39 Years	20%
	40 – 49 Years	37%
	Above 50	38%
Education Level	Below G.C.E Ordinary Level	25%
	G.C.E Ordinary Level	39%
	G.C.E Advanced Level and diploma	30%
	Bachelor Degree	5%
	Post Graduate	1%
No. of years in the operations	Below 3 years	39%
	3 –5 Years	49%
	6– 9 Years	8%
	Above 10 Years	4%
No. of Employee Working	Below 5	57%
	6 –10	23%
	11-20	16%
	Above 20	4%
Level of capital invested	Below Rs.500,000	18%
	Rs.500, 000 - Rs.1,000, 000	49%
	Rs.1,000,000 - Rs.2,000,000	18%
	Above Rs.2,000,000	15%

Source: Author Constructed

These findings highlight that most SMEs are small, male-dominated businesses with moderate levels of experience and varying educational backgrounds, a minimum level of employees and operating primarily with limited capital investments.

4.2. Reliability Analysis

The WCM, IAP, and FP scales demonstrate strong internal consistency, with high Cronbach's alpha values of 0.857, indicating that the items within these scales are highly correlated and effectively measure the same underlying construct. The AIS scale also shows good internal consistency, with a Cronbach's alpha of 0.811. The FIN scale has an acceptable Cronbach's alpha of 0.725, while the FRA scale, with a Cronbach's alpha of 0.701, remains within the acceptable range for reliability, though slightly lower. Table 2 demonstrates the reliability results.

Table 3: Reliability Analysis - Cronbach's alpha

Variables	Cronbach's Alpha
Working capital management Practices	.857
Financial reporting analysis practices	.701
Accounting information system	.811
Financing	.725
Investment appraisal practices	.857
Financial performance	.857

Source: Author Constructed

4.3. Financial Management Practices of SMEs

The analysis considered the mean and standard deviation of the variables to assess the extent of financial management practices adopted by SMEs. Based on the decision criteria outlined by Abanis (2013), the levels were classified as follows: Low ($1 \leq Xi \leq 2.5$), Moderate ($2.5 < Xi \leq 3.5$), and High ($3.5 < Xi \leq 5.0$).

Table 4: Adoption Level of Financial Management Practices

Variables	Mean	Standard Deviation
Working capital management practices.	4.08	0.379
Financial reporting analysis practices	4.02	0.218
Accounting information system	4.07	0.348
Financing	4.05	0.440
Investment appraisal practices	4.04	0.351

Source: Author Constructed

Key financial management practices have been widely adopted at a high level among SMEs, indicating that they recognize the importance of these practices for enhancing profitability and sustaining their operations.

4.4. Correlations Coefficient

Table 4 presents the statistical correlations between the variables. Financial performance shows a strong positive correlation with Working Capital Management Practices ($r=0.793$, $\rho<0.00$) and Financing Practices ($r=0.705$, $\rho<0.00$). In contrast, its correlation with Financial Reporting and Analysis Practices is relatively weak ($r=0.238$, $\rho<0.00$). Moderate positive correlations are observed with Accounting Information Systems ($r=0.598$, $\rho<0.00$), Investment Appraisal Practices ($r=0.405$, $\rho<0.00$), and Financing Practices. These correlation coefficients indicate that financial management practices are significantly associated with the financial performance of SMEs. Further, the correlation results indicates that the performance

of the SMEs is highly connected with financial management practices. These results are supported with previous researchers (Kengatharan, 2020; Somathilake and Pathirawasam 2020; Sooriyakumaran et al., 2022).

Table 5: Correlation coefficient

Correlations	WCM	FRA	AIS	IAP	FIN
FRA	.067	1			
	.132				
AIS	.772**	.329**	1		
	.000	.000			
IAP	.367**	.355**	.504**	1	
	.000	.000	.000		
FIN	.828**	.103*	.716**	.372**	1
	.000	.021	.000	.000	
FP	.793**	.238**	.598**	.405**	.705**
	.000	.000	.000	.000	.000

**, * Significant at 1% and at 5% level respectively

Source: Author Constructed

Working capital is a critical factor in managing the day-to-day operations of an organization, playing a vital role in ensuring smooth functioning. For SMEs, effective working capital management is especially important as it significantly impacts profitability. A strong positive correlation indicates that effective working capital management is closely associated with higher profits in SMEs. Additionally, the financing structure of these organizations is intricately linked to the cost of capital; the proper utilization of debt can lead to tax benefits and further enhance profitability. High positive correlation indicates that SMEs effectively utilize appropriate financing structures. AIS facilitates finance-related decision-making, supports daily operations, and enhances accountability for financial resources. A moderate positive correlation suggests that AIS fosters an environment conducive to profitability in SMEs. Investment appraisal processes are essential for selecting suitable projects that yield profits for SMEs. The moderate level positive correlation shows adoption of investment appraisal practices influences to earn profits in SMEs. Meanwhile, financial reporting and analysis serve as a retrospective examination, providing detailed insights into past transactions. This analysis aids in future decision-making and helps rectify previous errors. However, the analysis of financial statements shows a weak correlation with overall financial performance.

4.5. Regression Analysis

Table 5 presents the results of the multiple regression analysis conducted in this study. These findings illustrate the collective impact of financial management practices on the financial performance of SMEs, offering valuable insights into the strength and nature of these relationships.

Table 6: Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	P value
	B	Std. Error	Beta		
Constant	.426	.159		2.682	.008**
WCM	.603	.038	.814	15.808	.000**
FRA	.294	.039	.218	7.638	.000**
AIS	-.211	.036	-.271	-5.922	.000**
IAP	.104	.030	.104	3.506	.000**
FIN	.110	.031	.164	3.593	.000**
R^2	.693				
Adjusted R^2	.690				
F Statistics	223.189				
Prob	0.000**				

** Significant at 1% level

Source: Author Constructed

The regression results above indicate that financial performance was influenced by Working Capital Management Practices (WCM), Financial Reporting Analysis Practices (FRA), Accounting Information System (AIS), Investment Appraisal Practices (IAP) and Financing Practices (FIN).

Regression analysis reveals that approximately 69.0% of the variance in financial performance is explained by financial management practices, as indicated by the high adjusted R^2 value. This underscores the substantial collective impact these practices have on financial performance. The regression results also highlight the strength and direction of these relationships, with positive coefficients for Working Capital Management Practices (WCM), Financial Reporting and Analysis Practices (FRA), Investment Appraisal Practices (IAP), and Financing (FIN), indicating that improvements in these areas lead to better financial outcomes. These findings are supporting with the studies done by Kengatharan (2020), Sooriyakumaran et al. (2022) and Osamor et al. (2021).

The statistical significance of the overall regression model ($F=223.189$, $p<0.05$) confirms that the model fits the data well, demonstrating that the independent variables significantly predict financial performance in SMEs. Hypothesis testing further supports these findings, as both the correlation and regression analyses validate the significant relationships between financial performance and the financial management practices examined. This statistical evidence emphasizes the critical importance of adopting sound financial management practices to enhance financial performance.

5. CONCLUSION

The objective of this study is to identify the financial management practices employed by SMEs and assess their impact on financial performance, given the critical role SMEs play in the nation's economy and the relevance of financial management to their success. Using convenience sampling, 500 SMEs were selected for the study. The findings revealed the impotence of the application of various financial management practices, including Working Capital Management Practices (WCM), Financial Reporting and Analysis Practices (FRA), Investment Appraisal Practices (IAP), and Financing (FIN), for the SMEs performance. All these financial management practices were widely adopted by SMEs and had a statistically significant positive impact on their financial performance. The study concludes that sound financial management practices are essential for improving the financial performance of SMEs.

Recommendations and Implications

Given the strong correlations and high R^2 value, SMEs should emphasize the practices of working capital management, financial reporting and analysis, accounting information systems, investment appraisal, and financing to improve financial performance. Regular assessment and adjustment of these predictors may be necessary to maintain model accuracy and reliability. Implementing time series analysis or more complex models could help refine the predictions if data is collected over different time periods. Consistently updating and refining data related to the financial practices of SMEs will help maintain the robustness of the model. Accurate and comprehensive data collection practices will support the ongoing validity of these findings. Extending the research to include more variables or different regions could provide additional insights and validate the generalizability of the model. Future studies could also explore other statistical methods or machine learning techniques to enhance predictive power. SMEs should focus on training and capacity building for managers in these areas. Additionally, policy implications suggest that government and financial institutions should provide support in terms of access to finance and training to ensure SMEs can sustain and improve their financial health, ultimately contributing to the broader economic development of the region. The study suggests additional studies on the effects of adopting financial management practices on specific SMEs' financial performance, like retailing, clothing, restaurants and other SME sectors. Future research should focus on exploring the impact of external factors such as government policies, economic fluctuations, and technological advancements on the financial management practices of SMEs in Sri Lanka.

Comparative studies between different industries might also reveal unique challenges and opportunities for SMEs, helping to tailor financial management strategies more effectively. Furthermore, longitudinal studies could track the long-term effects of financial management practices on the sustainability and growth of SMEs, offering a deeper understanding of best practices over time. Finally, integrating qualitative approaches to capture the perspectives of SME owners and managers could enrich the quantitative findings and provide a more comprehensive view of the factors influencing financial performance.

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