International Journal of Research in Finance and Marketing (IJRFM)
Available online at : http://euroasiapub.org/current.php?title=IJRFM
Vol. 7 Issue 6, June - 2017, pp. 45~59
ISSN(o): 2231-5985 | Impact Factor: 6.397 | Thomson Reuters Researcher ID: L-5236-2015

Financial Management Practices in Micro, Small and Medium Enterprises-An Exploratory Analysis with the help of Literature Review

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Abstract
The aim of this paper is take the literature reviews of the financial management practices to generate an insight into untouched and neglected area of micro, small and medium enterprises (MSMEs).The previous research studies identified the positive relationship between the financial management practices and MSMEs but no clear relationship established between the various components of Financial Management Practices viz working capital, capital structure and investment practices with profitability. Considering the nature of studies, the researcher selected limited but relevant and important 29 national and international research papers on the basis of non-probability based purposive sampling method. The literature analyzed on the basis of year, location, affiliation of author, aim of research, findings and conclusions. The researcher identified literature gap and developed major hypothesis for focused research studies. The study highlighted 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.

Key words: financial management practices, profitability, capital structure, investment practices, poor financial management

1.0 Introduction

Micro, Small and Medium Enterprises (MSMEs) are important for future economic development and for the continued evolution of a modern knowledge based economy. An important key to the successful development and survival of MSMEs is the role of financial management which is largely recognized by the previous research studies carried out in the areas of financial management. Unlike large firm, small firms and entrepreneurs operates in different business environment. Hence there approach and methods of managing finance substantially differs. Normally it is common observation that those people who run business they hardly look after financial matters. The reasons may be they lacks financial knowledge and skills or they are preoccupied with other business functions like purchasing, production and in managing human relations. Other reasons sighted includes owners-managers lack of interest in recording business transactions, preparing and analyzing financial statements. Most of the time owner-manager give second importance to these financial activities and rely on external accountants or advisor for their services to manage the financial side of their businesses. Financial management is a critical and crucial function in business management as each and every business operations have financial implications. If financial management decisions like working capital decisions (short term), capital budgeting decisions (Long Term) capital structure and dividend decisions are not taken on the basis of quality financial information and with appropriate use of financial tools and techniques, business may run into failure. The most of the businesses fail because they are not managed like business.

The growth of MSME sector is the result of the major restructuring of the Indian economy, growth in the service sector and positive government policies. This has led to an increasing interest in how a MSMEs monitors and control their finance. Lack of knowledge of financial management combined with the uncertainty of business often leads to MSMEs to serious problems regarding financial performance. It is commonly held belief that better financial information means better control and therefore improved chance of success. The previous research studies in financial literature identified the importance of sound and efficient financial management practices in improving the business performance. The previous research studies also recommended that the firms should adopt and use sound financial management practices so that failure of businesses can be prevented.

Performance is one of the most important objectives of financial management because on goal of financial management is to maximize the owner's wealth (McMahon,2005).Jen (2003) found performance to be a significant determinant of a small firm's credit risk. Edmister (2007) suggested that the small firms need to concentrate on the performance. Performance is very important in determining the success or failure of business. The aim of business is not only the generation of sales but also generation of profits which influence performance of SMEs. Profit is an indicator of business efficiency and necessary for the survival and growth of business
Commonly expressed views about small firm owner is that they are assumed to be naïve about planning and the development of strategy. Also expressed is the view that small firms lack financial skills and understanding of financial information (Lawson, 1995).It is only recently that such views are challenged.

1.1 Rationale for the study

The MSMEs act as an engine of growth for the economy. It's well recognized and widely appreciated potential in generating source of employment and income in the development of the economies cannot be underestimated all over the world. In the developing country like India, MSME sector acquired specific significance. The government initiatives like 'Make in India', 'Start Up India' and 'Skill India' will bear fruits if MSMEs survive, sustain and contribute successfully in ever changing competitive dynamic environment.

Chittenden et al(1999) sighted poor or careless financial management as a major cause of business failure. Hence he expressed that there is a definite need to for more information on the methods used by small firms to accumulate and allocate their scarce financial resources. Perren et al.(1999) concluded that the owner-managers in small firms move from informal methods of financial management and decision making to more formal methods as businesses develop. Nayak and Greenfield (1991) indicated that major studies in small firm financial management rely on the postal questionnaire survey methodology which are static in nature and lacking in-depth insights. Yet major studies in financial management in small firms based on survey data. In India, the serious in-depth studies on financial management practices are rare. Unlike large firms, the financial management practices in small firms largely differs. It requires different sets of financial management practices as their nature, size and type of business environment to which they get exposed are substantially different than the large firms. Hence MSME sector deserve separate, focus studies so that through efficient financial management practices, the profitability, survival and competitiveness of the sectors can be enhanced and the rate of MSMEs failure can be reduced by bring level of professionalism in financial management. This study will also help in getting valuable insights into financial management decision making by owner –managers of MSMEs.

1.2 Objectives of the Study:

1. The aim of this paper is take the literature reviews of the financial management practices to generate an insight into untouched and neglected area of micro, small and medium enterprises (MSMEs).
2. To find out literature gap
3. To develop hypotheses for further research studies.

2.0 Literature Overview

The literature on Micro, Small and Medium enterprises (MSMEs) financial management is quite voluminous and it concentrate on different aspects of firm's management. For this research study, we have selected just a few major studies concentrating predominantly on various issues of financial management

The literature specifically concerning financial management and small firm is limited, but we review this literature before turning to the remaining sections of this research paper.

Berryman, J.(1994)surveyed and analyzed literature on small scale business failure and sighted managerial inefficiency as a root cause for small business failure. Further she identified poor financial management as a predominant reason responsible for small business failure. Within finance function, inadequate or no accounting record and deficiency in accounting knowledge were sighted as the biggest problems in her survey results. On the basis of survey results, she ranks other key financial aspect in order of their importance: 1. credit management, 2.inventory control,3. liquidity/cash flow analysis,4. lack of initial capital,5.control of accounts payable,6.administration of fixed assets and 7. Lack of finance. William (1986) shown financial management (28%), accounting (16%) and management incompetence and inexperience (15%) were the predominant causes of small business failure. Further in his survey he found poor accounting records (55%) and inability to use financial statements (18%) were the most poor aspects of the finance function in failed firms. From the study, it seems that inefficient financial management of the finance function is the most critical aspect of functional management and this includes poor accounting.

Jarvis,et al(1996) challenge the assumption of financial management weakness in small firms and argue that decisions made by small owners can be better understood through approaches grounded in using the reality of environment in which they operate.

Also using 'grounded theory' and an ethnographic approach, Shaw(1997) has revealed the importance of bartering in small firm networks as well as sophisticated financial exchanges and exchange of knowledge by such entrepreneurs.

Grablowsky(1984) identified the differences in stock control techniques between large and small companies. The large companies use statistical methods and the smaller companies used anticipation (32%), past experience (15%), judgment (6%), and no method. The study concluded that the SMEs are long away from a reliable system to control inventory

Nayak and Green field (1991) in their survey addressed the issues of West Midlands companies. This survey analyzed what information small and micro firms use to control their business and how they use this information. The researcher investigated the difficulty of keeping accounts, gathering information and book keeping. The study also indicated that the cash book is the most typical form of financial record but a key issue was the use of this information made by the owner –manager. They concluded that the SMEs need advice on areas like keeping debtor records, chasing up debts; at start up to develop simple information gathering systems to prevent failure, well designed pro-forma for budgets, assistance on weekly profit calculations and help in business monitoring.

Turner (1997) has suggested that owner-managers should change from a task focus to a behavioural focus, from a passive record keeping focus to an active control of finance, with greater skills needs for advisers and owner-managers of businesses.

While commenting specifically on family companies, Poutziouris et al.(1998) identified issues that affect the need and perceived need for good information systems These includes situations of high ratios of fixed assets to total assets, low investment in intangible assets, high investment in stocks and work-in-progress and low trade creditors' repayment period. These could indicate a lack of confidence or a lack of understanding of how a modern system might be used to aid decisions or a limited perceived need for financial control systems. The researcher also indicated that this could also be the importance of the attitude and characteristics of a small firm owner manager in investing time and money in a better financial control system that would allow secure growth of company in the medium term

Peel M.J. & Wilson(1996) studied Working Capital and Financial Management Practices of Small Firm Sector based in North of England .Their survey results indicated that majority of the small firms use quantitative working capital and capital budgeting techniques to review various financial aspects in their companies. Besides this, the research study also found that those small firms which use the more sophisticated discounted cash flow capital budgeting techniques are also active in respect of working capital management practices. The study also revealed that the growing small companies will face liquidity problems. The survey finding indicated that there is a strong connection between good credit management practices and aspects of company performance specifically related to managing the efficiencies in cash cycle and profitability. The researcher expressed the need to have future theoretical and empirical research contributions in the important and neglected area of small business research.

Garcia-Teruel et al.(2007) found a significant negative association between working capital management and MSE profitability in their research entitled "Effects of Working Capital Management on MSE Profitability in Spain". In contrast , Uyar (2009) showed significant positive correlations between working capital components with firms' performance in Malaysia.

Padachi,at el.(2010) reveals the disproportional increase in current asset investment in relation to sales resulting in sharp decline in working capital structure. The suggested that the SMEs should concentrate on the short term funds since they frequently suffer from the lack of working capital

Graham and Harvey (2001) surveyed 392 chief financial officers to ascertain practices related to the cost of capital, capital budgeting and capital structure. The survey indicated that the large firms relied heavily on present value techniques and the capital asset pricing model; in contrast, small firms relied more on payback criterion.

Waweru,C. & Hgugi,K.(2014). Explored the influence of Financial Management Practices on the Performance of Micro and Small Enterprises in Kenya. The questionnaire used to collect data through a sample of 95 respondents selected on the basis of simple random sampling method out of 10000 management staff in MSEs.The research study examined the influence of four independent variables viz. financial innovations, investing activities, risk management practices and working capital management on financial management practices as a dependent variable. The multivariate regression model was employed to determine the relative importance of four independent variables with respect to performance of MSEs.The study found out that financial innovation influence the financial management practices to a great extent. The study recommended that the owner/managers of SMEs should embrace financial innovation in order to generate long term stability and competencies for business. Besides this SMEs should invest on regularly on the decision taken with the support of effective business support system.

Das A.K. and Dey N.B.(2000) conducted an exploratory research on "Financial Management and Analysis Practices in Small Business" in seven North Eastern states in 230 small scale companies. The structure questionnaire survey besides loose structure personal interview of owner-manager was taken. The non-random judgment sampling method followed. Finally researcher collected 208 duly filled questionnaire out of which 191 duly filled in correct questionnaire were processed. The research proved that there is a wide gap between theory of financial management and actual practices by the small businesses in India and also show that firms not doing well are less likely have to knowledge on financial management and proper business records. The researcher also find that the modern financial management tools and financial management theory developed is less useful or the small scale companies. The researcher recommended to develop altogether different set of financial management tools which can be useful to them for elevating the business level performance

Nguyen,K.M.(2001).examined the relationship between financial management and profitability of SMEs to determine whether financial management practices and financial characteristics impact on SME profitability. The thesis provides descriptive findings of financial management practices and financial characteristics and demonstrates the simultaneous impact of financial management practices and financial characteristics on SME profitability. In addition, the research study provides a model of SME profitability, in which profitability was found to be related to financial management practices and financial characteristics. With the exception of debt ratios, all other variables including current ratio, total asset turnover, working capital management and short-term planning practices, fixed asset management and long-term planning practices, and financial and accounting information systems were found to be significantly related to SME profitability.

Hall and Young (1991) studied 100 small enterprises that were subject to involuntary liquidation in 1973, 1978 and 1983.The authors found that the 49.8% reasons given for small firm failure were of financial in nature. Beside this, 86.6% of the 247 reasons given were of financial in nature when the perception of the official receivers interviewed for the same small enterprises.

Bhunia (2012) examined relationship between default behaviors of SMEs and credit facet of their owners. The results of the study indicated that 'credit will' variables and 'personal credit' history have the closest relationship enterprises' default probability and the proportion of overdue loans. The researcher opined that identification and measurement of credit risk of SMEs is different than that of large firms as SMEs are directly and significantly influenced by owners. Hence researcher is of the view that more effective and appropriate way of credit management of SMEs could be applied in practice.

Newman et al.(2012) investigated the firm level determinants of capital structure in Chinese Firms and tested them against the prediction of financial theory. The authors found that the firm size and profitability were both found to be related to leverage as proposed by pecking order theory. In contrast little support was found for the predicted relationship between asset structure and leverage.

Czarnitzki and Hottenrot (2011) examined the non-linear relationship between the working capital management and profitability of SMEs in Germany and observed that there is concave relationship between working capital level and firm profitability, which indicates that SMEs have an optimal working capital level that maximizes their profitability.

Klapper et al.(2002) attempted to understand the financing patterns of 97000 private and publicly traded firm in 15 Eastern and Central European countries. The authors were of the opinion that little is known about the relative importance of equity, debt and inter-firm financing for SMEs across countries.

Jindrichovska,I.(2013) reviewed recent studies on financial management in SMEs and addressed three core elements of financial management viz. liquidity and cash flow management, funding and long term asset acquisition. The author identified poor financial management of owner-managers is the main cause underlying the problems of SMEs.

Abanis,T.,Burani,A., and Eliabu,B.(2013).determined the extent of financial management practices employed by SMEs as to working capital management(cash management, accounts receivable management, inventory management practices)investment, financing ,accounting information systems and financial reporting and analysis. The findings of the study revealed that the extent of application of financial management practices is low among SMEs. The Pecking Order theory proved in case of research study. Authors recommended that SME owner should be sensitize towards financial management practices and SMEs access to financing needs to be improved.

Vohra,P.S. and Dhillon,J.S.(2014).studied various effects of financial management practices on small firm performance through questionnaire based field survey. The data collected from 103 owner/managers from a random sample of SMEs located in the 4 cities of Punjab state of India. This research finds detailed consequence of financial management practices on firm performance which mediate via financial planning capabilities. It covers 4 aspects mainly include, financial forecasting & budgetary planning capabilities, working capital planning capabilities, inventory management capability, financial reporting & financial analysis capabilities

Brijlal,P., Enow,S., and Issacs, E.B.H.(2014).investigated the Use of financial management practices by small, medium and micro enterprises in South Africa. The authors found that more than half SMMEs rely on external accounting staff to prepare accounting reports and more than 60% rely on external accounting staff to interpret and use accounting information. The study also revealed that SMMEs owners lack interpretation skills and awareness of using information from financial statements. The study recommended that policy makers, academic institutions and banks and business support organizations should focus on educating SMME owners so that risk of cash flow problems and business failure can be mitigated.

Mazzarol,T., Reboud,S.B. and Clark,D.C.(2015).examined financial management practices in small to medium enterprises (SMEs) from a case study survey of 289 small business owner-managers across 30 industry sectors in Australia and Singapore. The findings show that SMEs have largely informal and ad hoc financial management practices. Differences by size and financial literacy levels were found. As the firm grows in size and complexity the owner-manager is required to adopt more sophisticated and systematic approaches to financial management. SMEs with higher financial literacy have greater capacity to monitor and control the financial performance of their businesses.

2.1 Summary of literature review

The literature on small firms' financial management practices is very broad in nature and touches the different aspects of finance in varied context of firm's life. The initial interest of research in SMEs failure and default risk which has widen to studies investigating the financial management practices viz cash management, account receivable management, trade credit, inventory management, financial planning, performance and analysis ,capital budgeting to accounting information related practices. Initially the focus was on level of adoption of financial management practices. In later period it tried to establish and examine the relationship between the financial management practices and its impact or effect on financial performance of the firms. In the subsequent years, the simultaneous impact of financial management practices and financial characteristics on financial performance studied by few authors. Yet the exact relationship and impact of financial management practices on profitability is not clear. The definitions of SMEs varies from countries to countries. The financial management practices of SMEs related research studies conducted in different countries like underdeveloped, developing and developed countries of Asia, Africa, Europe, United States and Australia. The nature and focus of studies varies. The variations in studies observed in terms of research methodology, sample size, size of firms, listed unlisted firms, and private and public firms. The studies also varies on the basis of data collection i.e. primary and secondary data. The initial studies related to financial management practices were based on questionnaire survey. Later on, survey plus secondary data extracted from financial statements used for analysis of financial management practices. The statistical tools like mean, mode median, spearson's correlation coefficient, multiple correlation and regression analysis, one way and two way ANOVA and t-test, factor analysis etc. were used in various studies related to financial management practices.

2.2 Literature gap:

- Still little is known of the financing pattern, their relative importance and impact on SMES profitability.

- Exact relationship and effect of various financial management practices on the profitability is not established.

- Financial management tools, techniques and practices of SMEs are not yet developed as financial management theories are mostly and specifically designed for the large firms.

- Major financial management decisions like investment, financing and profitability are interrelated and interdependent. The holistic studies considering all financial management decisions and their effect on profitability are lacking. The financial management practices are either focusing on some or other aspect of financial management decision.

- The majority of the financial management practices studies are related to the large firms listed on stock exchanges. The focus studies on SMEs are lacking specific to industry sector.

- The most of the financial management practice studies on SMEs are conducted in developed countries. Their business and financial environment, sophistication of banking and financial system, government laws, level of financial literacy and entrepreneurship culture differs a lot compared to the developing and developed countries.

3.0 Hypotheses developed for the study

1. There is a significant relationship between the owner-managers financial management knowledge and competencies with the financial success of SMEs.

2. There is a significant positive relationship between the active involvements of owner-manager in using financial management practices with the financial performance of the SMEs.

3. Inability to interpret and use financial statements is related with SMEs failure

4. There is a significant difference in the financial management practices adopted and used in SMEs and Large firms

5. There is a significant difference in the level of use and application of financial management practices in developed and developing countries

6. There is a significant positive relationship between the effectiveness of management control system and financial performance of SMEs

4.0 Conclusion:

The economic and social development across the globe is greatly impacted by the part played by the Micro, Small and Medium Enterprises (MSMEs). The MSMEs play a key role in development of the economy with their effective, efficient, flexible and innovative entrepreneurial spirit. In order to keep the momentum of growth and holistic development, it is imperative that the MSME sector is empowered to meet challenges that can threaten their survival and growth. The literature findings sighted managerial inefficiency as a root cause and poor financial management as a predominant reason responsible for MSMEs failure. Hence study concludes that the financial skills and knowledge of MSMEs owner-manager needs to be improved so that with the use of modern scientific financial tools and techniques better financial management decisions can be taken which are essential for survival, growth and profitability businesses.

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Harif et al.(2010) did a research on the financial management practices o SMEs in Malaysia, with the results indicating that lack of working capital which account ted for 93.6 per cent is the most common weakness in the area of financial management

Nyamao et al (2012) conducted a study to elucidate the WCM practices of SMEs in Kenya using a sample of 113 SMEs. They concluded that WCM practices are low amongst SMEs as majority had not adopted formal WCM routines.

Agyei-Mensah (2010) also conducted a research into the WCM practices of SMEs in the Ashanti region of Ghana using a sample of 800 randomly selected firms. The study revealed weak WCM skills within the sector. He concluded that the education level and work experience of managers are very important to the effective and efficient WCM.

Godfred Adjaong A. (2013) in their research paper on "Working Capital Management practices of UK SMEs: The Role of Education and Experience" reported the results of an investigation into the effect of education and work experience possessed by managers on the working capital management practices of Small and Medium Enterprises (SMEs) listed on the Alternative Investment Market (AIM), from the perspective of financial directors. The analysis is based on questionnaire distributed to 248 AIM listed SMEs. The paper employs the T-test, one way ANOVA and past hoc test on responses from 72 managers of AIM listed SMEs. The result show that manger with the highest qualification and many year of work experience have the ability to confidently managing all aspects of WCM, and therefore have the best WCM practices. Specifically results indicate that managers possessing professional qualification are more competent and therefore able to manage all the WCM components. Also, managers with 21 years or over o work experience have the best WCM practices.