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# The Influence of Financial Monitoring on Performance of Small and Medium Enterprises in Tanzania: 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 theory. Cross-sectional research design and quantitative research approach were used in the study. Structured questionnaire* was *used to collect data from a sample of 204 SMEs in Arusha City Council. The regression analysis of data established that, financial monitoring in SMEs results in significant increase in sales revenue, profits, product lines and number of customers. The findings provide an indication that, financial monitoring is critical in ensuring positive performance of small and medium enterprises. Hence, owner-managers should capitalize in managing business finances and make close monitoring on all financial matters for the improved performance of their ventures. Similarly, the policy makers and training institutions need to have a well- established framework to assist SMEs on matters related financial monitoring and provide relevant trainings on key features of financial monitoring for improved performance of SMEs.*

**KEYWORDS**: financial monitoring, small and medium enterprises, performance

## INTRODUCTION

Small and Medium-Sized Enterprises (SMEs) are significant driver of economic development world-wide (Razak, et al., 2018). It is estimated that SMEs account for the two-third job opportunities globally (Obi, et al., 2018). However, in developing and emerging economies, SMEs are far less productive than larger firms (Koirala, 2019). Due to lower productivity and the inability to meet international product standards, SMEs in developing economies struggle to deliver the required product quantities at consistent quality and are less likely to significant exports (Tambunan, 2020).The mismatch performance is observed to be more related to internal management and control of the available resources than other external factors to the firm (Ademola, et al., 2020).

The SMEs in the developing economies like Tanzania are faced with limited capital margins (Abdissa, et al., 2022). Limited capital margin may require these enterprises to keenly monitor the available resources to ensure their growth and sustainability. Proper monitoring allows the business identify the activities where resources should be channeled, how the resources are utilized and where improvements are needed (Musah, et al., 2018). Accordingly, monitoring helps the business in determining whether all business activities are carried out properly, timely and that bring the expected benefits (Vovk, et al., 2020). Additionally, firms require proper monitoring of finances since strong financial muscles provides numerous competitive advantages to the firm (Bosetti, 2021).

Evidence from the evaluation of determinants of management success skills in enterprises shows that, proper organization structures, monitoring and innovativeness are key to the success of SMEs (Asikhia & Naidoo, 2020). Hence, through monitoring awareness and overall evaluation of the ventures, owners of the business are likely to develop programmes and practices that add value to their firms. Past literature however, were mostly confined on the overall monitoring of the firm activities and more specifically the financial management and internal control activities; the results which cannot well explain financial monitoring and its importance on the performance of the business. In this regard, there exist scanty literature relating financial monitoring and performance in SMEs in Tanzania. The central question of the present study is that, does financial monitoring influence the performance of SMEs?

The study is grounded on the resource- based theory with the view that, organizations compete against others on the basis of their capabilities and resources (Barney, 1991). Based on the theory, the performance of the firm is enhanced by both financial and non-financial capabilities. Basically, SMEs are expected to improve their performance and accrue the capital invested for the improved welfare of their owners and contribute positively to the nation income (Ahsan, 2022). Thus, the behaviour of owner-managers to make close follow-up on the finances is of paramount importance to the success of their firms.

## Rationale of The Study

SMEs are the key engine for the country's development. They are widely recognized as a source of employment and income at individual and national level and that their contribution to the economy cannot be underestimated. Thus, their positive performance is vital. The study contributes to the existing business management literature on the predictors of performance in SMEs. A positive significant relationship established between financial monitoring and performance provide a strong reason for emphasizing the importance of close monitoring and follow-up on business finances in SMEs.

## LITERATURE REVIEW

### Performance features in SMEs

Performance in the business context is measured through the evaluation of predetermined goals against actual outcomes as expressed in financial or non-financial terms or both (Rashid, et al.,

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2018). Performance is thus defined by the capability of the firm to achieve the goals of the main stakeholders (Nur & Zulkiffli, 2014). Different dimensions including sales revenue, profits, return on shareholders wealth, change in number of employees and customer satisfaction are used to expressed the financial status of SMEs (Salleh, et al., 2018; Rashid, et al., 2018). In other literatures, return on capital employed, improvement in household welfare, survival, cost minimization, market share, new product development and employees' satisfaction are used to express the performance in a firm (Brzostek & Michna, 2016; Michna, 2018). The list of performance indicators in business is endless and there is no agreement of specific measure to use, rather the selection of the performance indicators is much based on the business context and owner-managers' interest in the business (Bulak & Turkyilmaz, 2014). In the present study performance was measured in relation to the sales revenue, number of customers, profits and introduction of new products. The selected performance maesure are considered to be the primary measures of performance in businesses and that they can easily be traced in the context of small businesses (Bulak & Turkyilmaz, 2014).

Besides, the performance of a firm can either been measured objectively whereby actual financial data are captured from the financial information stored in the firm (Annisa & Mahendrawathi , 2019). Alternatively, , firm performance can be measured subjectively based on the perception of the owner-managers on the changes in the performance in a specific period of time (Vij & Bedi, 2016). Studies acknowledge that, the findings of the objective and subjective measurements are closely related especially in the context of small businesses (Khan, et al., 2014; Vij & Bedi, 2016). Principally, small businesses have a tendency of less keeping financial information because of their smallness nature, and some of them hestitate to reveal their true financial data to avoid government taxes and levies (Vij & Bedi, 2016; Masanja, 2019). Thus, both objective and subjective performance measurement approaches are said to be closely related. The fact that, owner-managers observation of performance of his business is considered to produce equal results with those of objective measures, either of these measurement approaches can be used in small businesses (Azam, 2014). With this understanding, the performance of SMEs in the present study was measured subjectively whereby the respondents were asked to indicated if the performance of their enterprises has been increasing, decreasing or remained the same for the period of three years

## Financial Monitoring and firm performance

Extant literature indicates that, monitoring provide a business entity with valuable information that enriches decision making process (Belas, 2021). Thus, monitoring involves formative evaluation of the business to understand its direction and outcomes, the information that is used to correct or maintain the status quo. With proper monitoring, firms are likely to establish whether the business operations are carried out as planned and whether the pre-set objectives are likely to be achieved (Fornasari, 2021).

Basically, monitoring is one of the internal control tools which provide an enterprise with formative evaluations for profitable decisions (Arushacc.go.tz, 2022). In their study, Ademola, et al., (2020) assessed the effect of internal control systems on operating performance in SMEs, the study which captured such factors as monitoring, risk assessment, information and communication, control activities and environment. Thus, monitoring captures on-going evaluations of the activities in an enterprise.

Specifically, financial monitoring entails capturing financial matters of the firms with the focus of minimizing loses, theft, risks, inaccuracies and mismanagement of funds (Francis & Imiete, 2018). Financial monitoring has been identified as a market instrument in banking industry specifically in innovation and digitalization of services (Vovk, et al., 2020). Their study identified that, financial monitoring in the banking industry has improved and that it is used as a competitive tool in the market for improved performance. Besides, financial monitoring facilitates the evaluation of risk alerts in business. A study by Belas (2021) established that, through financial monitoring firms are in a position to identify the drawbacks of providing some specific products items and lines and the challenges associated with servicing specific customer groups. This information is pertinent for resource allocation and investments decisions which affect future performance of the firms.

Moreover, Robert Odeka and Elmad Okoth (2019) established that, management of finances in small and medium sized firms enhances fims profitablity. Their study which was conducted in distribution firms in Kenya established that, strong internal control and proper management of finances provide significance improvenebt in the financial performance of a firm. Besides, a study on financial management practices, firm growth and profitability (Musah, et al., 2018), indicated positive relationship, although their study took the combined effect of finacial reporting, working capital management and capital budgeting in relation to the performance of the SMEs while focusing lesser on specific financial monitoring activities.

Notably, financial knowledge and comptencies in interpreting financial information and owner-managers involvement in making close follow on financial matters of enterprise are highly associated with success or failures of a firm (Gawali & Gadekar, 2017). Their study explored the financial management practices which are associated with business survival, growth and profitability. The findings indicated that, most micro, small and medium scale businesses fail because they are not managed like businesses and that they lack close monitoring and control of their finances.

It is worthnote that, most of the financial management practices studied in the previous literature looked on the combined effect of such practices as cash management, working capital management, risk assessment and budgeting issues. Exactly relationship between financial montoring and performance in the context of SMEs is not established. Hence, little is still known on financial monitoring in SMEs and its importance on the performance, which was the focus of the present study.

## METHODOLOGY AND RESEARCH DESIGN

The study population was SMEs whereby we studied a total of 204 SMEs in Arusha city council. The Arusha City is among the growing hubs of SMEs in Tanzania hosting a number of entrepreneurial activities (Kiwia, et al., 2019). A self-administered questionnaire was used to collect data using cross-sectional design. The cross-sectional design is relatively simple, cheaper and faster than longitudinal design. The study considered SMEs that have been in operation for at least three years with an understanding that, this period is sufficient to establish the business direction and outcomes (Kiwia, et al., 2019). The main respondents of the questionnaire were the owner-managers since most of the information in SMEs are kept with the owner- managers and that most of business decisions are made by them (Cicea, et al., 2019).

The study used quantitative approach whereby the causal relationship between financial monitoring and firm performance was established. Descriptive and inferential analysis were carried out to establish the nature of responses and the relationship between independent and dependent variables respectively.

### Measurement of the study variables

Financial monitoring was measured on a 5-points Likert scale of agree- disagree continuum. The owner-managers were required to respond on financial monitoring practices as to whether the firm effectively manage its finances, make financial monitoring on week, monthly or annual basis. The owner-managers were also required to identify whether they have adequate knowledge on financial monitoring and whether they use financial experts to manage and monitor their finances. In measuring the performance, the owner-managers were required to identify whether their sales volume, number of customers, profits and product lines have been changing for the past three years from the data collection period. A 5-points Likert scale was used to measure SMEs performance and the questions were placed on an increase- decrease continuum.

### Reliability and Validity

A number of procedures were done to ensure validity and reliability of data collection instrument and that of data collected. Firstly, the study was confined on structured questions limiting extra explanations that could introduce personal opinions and biasness. Literature indicates that, one approach of ensuring data reliability and validity is by using a well-structured questionnaire (Middleton, 2022). Well- structured questions produce similar results if are repetitively used under similar research settings (Song, 2017). A 5-point scale was opted for to have a moderate number of choices with the focus of minimizing confusion which arises to the respondents where higher scale points are used. This helps to enhance reliability and validity of the results. Basically, a 5-points scale is commonly used in management and business studies (Mirahmadizadeh, et al., 2018). On the other hand, the questionnaire was checked for relevance of content, coverage and clarity. This is was done with the help of the research experts and few professionals in the small business studies.

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Moreover, the questionnaire was pre-tested with few a SMEs owner-managers before full execution of the study. The results were tested for internal consistence and it was established that all items had Cronbach's value of 0.7 which indicates good reliability (Saunders, et al., 2016), and hence were accepted for further processes.

## RESULTS AND DISCUSSION

Our study focused on establishing the relationship between financial monitoring and performance of SMEs. Out of 204 questionnaires which were distributed, 188 were filled and returned providing a response rate of 92.1% which was considered adequate for carrying out further analysis. Descriptive data were firstly analysed followed with inferential statistics. Regarding financial monitoring items, the responses were coded as 1= strongly disagree, 2= disagree, 3= Neutral, 4 = agree and lastly 5= strongly agree whereby 3 is the mid value

The perceptions of the respondents on effective management of the business finances received the highest mean score (4.98) implying that, the SMEs well manage their finances. This was followed by an item which showed that SMEs do financial monitoring on monthly basis (Mean = 4.63). From these results, it was also observed that, SMEs do not use expert to do financial monitoring (Mean= 1.37) and that they do their financial monitoring. Although owner-managers do financial monitoring on their own, they claimed have moderate knowledge on this activity (Mean = 3.26). Besides the respondents indicated that, they update themselves on the best financial monitoring practices; the item which received a mean score of 3.21.

Regarding the descriptive information on the performance of SMEs, the questions were asked to identify whether there has increasing trends of the performance indicators used in the study. The items were captured as 1= highly decrease, 2= decrease 3= neutral 4= increase and 5= highly increase. The results indicate highest increase in number of product lines for the period of three year with mean score of 4.22.This was followed with the increase in sales volume with a mean score of 4.07, increase in number of customers (3.85), increase in profits (3.63) and the last was the overall improvement of the business performance which scored a mean value of 3.56.

Normality of the collected data was established by computing skewness and kurtosis values. According to Kline (2005) and Kline (2011) skewness ranging from -3 to +3 is acceptable and kurtosis below + 10 is accepted. The skewness for financial monitoring items ranges from -0.408 to +1.5 while kurtosis of the items was found to range between 1.167 to 3.25; the value which fit in the accepted ranges. On the other hand, the skewness for performance items were found to range from -1. 42 to 2.11 and kurtosis was found to range from 2.27 to 6.21. This indicates that, all the examined items in the study variables in the current study were found to fall within the acceptable sknewness and kurtosis indicating normal distribution of data.

A linear regression model was used to test the effect of independent variable (financial monitoring) on performance of SMEs. The regression result indicated significant positive relationship between financial monitoring and performance of the SMEs. Using a 95% confidence level, p-value which

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is less than 0.05 indicates a significant relationship. Regarding the improvement of the overall performance, the regression analysis posted positive significant relationship with β = 0.396, p= 0.023. The results provide an indication that, a unit increase in financial monitoring increases the o performance of SMEs by about 0.4 units. On the other hand, the p = 0.023 indicates significant relationship between financial monitoring and the overall performance of SMEs.

Financial monitoring helps the firm determine is direction in terms of the finances. It entails monitoring the amount is invested in capital and in different operational activities of the firm (Simón-Moya, 2022). This helps to ensure proper decision making in the business. In line to this, Manoharan (2022) established that, one of the reasons for SMEs stagnant growth and performance is financial literacy and lack of financial discipline. This implies, proper monitoring of finances improves the overall performance of an enterprise.

Close financial monitoring helps the owner-managers analyze the direction of the firm in terms of the customer inflows, sales performance, profits and the capabilities to induce new product lines. This is evidenced in the present study in which the regression analysis posted positive significant relationship between financial monitoring and sales revenue with β = 0.410, p= 0.036. This means that, a unit increase in financial monitoring cause positive change in sales revenue of SMEs by 0.41 units. The results are in line with Simón-Moya (2022) who eatblished that, financial projections and follow-ups are important enginees to the future cash inflows of the business. Basically, monitoring provides a room for the ower-managers to form business strategies that match the prevailing business and market conditions (Kankaras, 2018). Thus, with proper monitoring, firms are in position to identify the stategic business units to invest in with the focus of impoving sales revenues.

Moreover, positive significant relationship between financial monitoring and change in number of customers was established with β = 0.244, p= 0.017. The significance relationship established implies that, the more SMEs do financial monitoring the high number of customers transact with the firm. The results provide an indication that, financial monitoring provide an opportunity for the firm to identify which customer segment is more profitable to invest in and therefore the services and products which fulfill the expectations of the customers. Thus, with effective financial monitoring, customers are more likely to be satisfied, purchase more and bring more customers through positive recommends; the behaviours which have multiplier effect on number of customers transacting with the firm, sales and profits.

In addition to that, the regression analysis between financial monitoring and profits indicated positive relationship where β = 0.173, p= 0.048. Principally, profit of a firm is a function of many factors including the number of customers, sales revenue and different costs. Positive significant relationship identified by the model provide an indication that, financial monitoring is a crucial element of the profitability of SMEs. A study by Robert Odek, Elmad Okoth (2019) which assessed the effect of internal control on the financial performance of SMEs in Kenya established that, financial management practices are crucial in enhancing the profitability of small and medium

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enterprises. However, different from the current study which studied financial monitoring and SMEs performance, their study looked on the combined effect of financial management practices on financial performance of SMEs.

Finally, financial monitoring was regressed against change in number of product lines in SMEs whereby positive significant relationship was established ($\beta = 0.210$, $p= 0.041$). The findings show that, a unit increase in financial monitoring results into increase in number of product lines by 0.21 units. Basically, the capability of a firm to expand in terms of introducing new products and going to new market segment depends much on financial muscles and capabilities to properly manage the available resources ( (Ademola, et al., 2020). Thus, a significant relationship established provides an indication that, financial monitoring provides an opportunity for the SMEs to invest in more product lines in responding to the needs of the market. The more a business investment in different product lines the higher likelihood of enhancing its sustainability in the market (Rosenfield, 2022).

## CONCLUSIONS AND IMPLICATIONS

Our study focused on establishing the relationship between financial monitoring and performance of SMEs. The findings reveal that, there exist clear connection between financial monitoring and performance of small and medium enterprises. Further, the study established positive significant relationship with sales revenue, change in number of customers, change in number of product lines and profits of SMEs; the performance indicators which were tested in relation to financial monitoring practices of a firm. Positive performance of SMEs in the market widens job opportunities which raises income to individuals, standard of living and consequently the contribution of these firms to the national income. Hence, determination of the factors and practices which raises the performance of SMEs is of critical importance. Financial monitoring helps to measure financial efficiency within a business by tracking expenditures against accrues and investments. Through financial monitoring, firms get light on the direction and outcomes of the business; the information that is critical in decision making process. On this note, the findings suggest that, financial monitoring helps SMEs widen their product lines, increase the number of customers, sales revenues and improve the profits. Thus, owner-managers of SMEs should shoulder the performance through close financial monitoring focusing on identifying areas were improvement is needed, where additional resources are needed and where less cash needs to be ejected.

That is to say, since financial monitoring is a continuous process, owners- managers need to be open-minded and put commitment to monitor the finances of their enterprises in continuous basis. This can be supported by having financial monitoring tools like policies or guidelines which act as a benchmark for firm financial matters. For example, the guidelines on how much to invest into different operational activities, how much sales are approximately expected at different business cycles and seasons and in which strategic areas an enterprise can venture. With this, policy makers, practitioners and trainers can play a role of providing knowledge to SMEs on financial monitoring as well as enabling environment for the business owners to monitor the finances for the development of the individual firms and the entire SMEs sector. This implies that, future performance of SMEs may require focused policy initiatives and commitment to establish a well-knowledged and skilled business society that can tap opportunities arising from financial well-being and work out challenges spotted as a result of financial monitoring practices within a firm.

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