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## Financial Management Practices and Growth of MSMEs of Tanzania

*Peter Gwesso Matare\* and T. N. Sreedhara\*\**

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### ABSTRACT

*The significant objective of this study is to explore financial management practices and the growth of MSMEs in Tanzania. This research was guided by the following objectives: financial innovations, investing activities, risk management practices and working capital management. Since the MSMEs population is quite high, the target population for this study was estimated at over 400 management staff from selected MSMEs in Dar es Salaam. The study discovered that financial innovations influence the growth of MSMEs of Tanzania to abundant scope and that the aim of innovation in an enterprise is to make a profit. The study also recommends that it is important for MSMEs to invest so that investments can grow to compete against inflation and future reservations. Managers should build an effective business support system as a key condition for the success of investment capacity building. The study found that there is a need to look at the challenges facing MSMEs of Tanzania.*

**Keywords:** *Financial management practices; Performance; MSMEs; Innovation; Dar es Salaam; Tanzania.*

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### 1.0 Introduction

The involvement of 'micro, small and medium enterprises' (MSMEs) is more than double that of the large manufacturing sector, which stands at 27% of the GDP of the Republic United of Tanzania (URT). Overall, MSMEs create 85% of all new jobs. Estimates show that, in the year 20015, the MSMEs sector had employed about 6,412,354 people, up from 18,928,900 in 2003 (Ebner, 2014). This was an increase of 986,000 persons and consisted of 84.7% of total national employment.

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*\*Corresponding author; Research Scholar, Department of Business Administration, Mangalore University, Mangalore, Karnataka, India (E-mail: gwesso2010@gmail.com)*

*\*\*Professor, Department of Business Administration, Mangalore University, Mangalore, Karnataka, India (E-mail: tnsree@gmail.com)*

The average income of organisations surveyed were about Tshs260, 000/- per month, and/or the minimum legal monthly wage for unskilled workforces in which the year 2010 was Tshs170, 000/-. The share of the MSMEs sector's contribution to GDP was estimated at 28.4 percent. It is recognized that MSMEs constitute a significant portion of the Tanzanian private sector. In Tanzania, MSMEs have contributed to the extension of price-based signals into areas such as urban service delivery; garbage collection, urban transport, water distribution and manufacturing of widespread domestic and commercial appliances (Baum and Wally, 2003).

The significance of Tanzania's MSMEs movement has continued to grow since the sector was brought to the publicity in the 1970s. In Tanzania, it widely acknowledged that the promotion of the MSMEs sector is the feasible and dynamic strategy for achieving national goals, including employment creation, poverty mitigation and balanced development within sectors. The findings of the 2013 MSMEs Baseline Survey underscored the important role that MSMEs play in Tanzania's development process, predominantly in the context of creating employment and income opportunities for the mainstream of poor people throughout the entire MSMEs of the region. MSMEs sector provides employment for considerably more people than does the formal enterprises' sector (Wanjiku, 2017).

### 1.1 Financial sectors of Tanzania

Financial Sectors are increasingly becoming more important for poor and developing countries (Neumann and Dul, 2005). Financial Sectors are considered an engine for economic growth and poverty reduction for the country through the creation of jobs and incomes for the people (Ebner, 2014; OECD, 2013; Richard *et al.*, 2009, Salum *et al.*, 2017). Financial Sectors development is also considered as a tool for economic survival during the country's crises (Flemming, 2014; Mori *et al.*, 2014). Also, Financial Sectors are considered as the private sectors for employment generation and sustainable growth" (Majama and Magang, 2017). Despite Financial Sectors' large contribution to countries' development and economic growth, their growth and development in developing countries were mainly inhabited by the access of finance, poor managerial skills, and lack of training opportunities and the high cost of inputs (Sandada, 2015).

Consequently, due to the Ministry of Industry and Trade in Tanzania, small businesses are collectively defined under the nomenclature Financial Sectors. The term Financial Sectors terminology is used to mean Financial Sectors. Also, it is referred to as Financial Sectors. Consequently, micro-enterprises are those engaging up to four people in most cases family members or with an investment not exceeding Tshs 5.0 million the

majority of which fall under the informal sector. Furthermore, Small enterprises are mostly formalized undertakings engaging 5 to 49 employees or with the capital investment of TSHS.5.0 million to TSHS.200 million. Medium enterprises employ about 50 to 99 employees and use the capital for investment from about Tshs 200 to 800 million.

### **1.2 Strategic planning**

Strategic planning, among other things, deals with assessing the internal and external business environment for the purpose of identifying organisational strengths, weaknesses, opportunities, and threats (Jackson, 2018). Based upon these financial sectors that firms formulate and implement organisational goals and determine the strategies to achieve them. Further, strategic planning is the attempt to prepare for future contingencies and thus to account for environmental dynamics and complexity. This involves the need to build alternative future scenarios and configurations. Though the future cannot be projected, it is possible to prepare for the future and/or alternative “futures” and align the enterprise accordingly. However, strategic management, planning is not concerned with the development of strategic goals and visions but rather deals with extrapolating present tendencies into the future. Consequently, strategic planning provides guidelines and programs for the achievement of specific goals and visions. It stipulates the basic situations as well as the scope for future business activities and is thus a key instrument for the overall strategic management.

Financial sectors are often the main drivers of economic growth and their survival and success are crucial to economic stability (Wauters, 2017). Similarly, as the number of financial sectors increases so does competition, which might then result in a decrease in prices, low customer base, or both. This influence, in turn, erodes existing profits and creates less incentive for people to start Financial Sectors. In this context adoption of strategic planning plays an important role in the survival of Financial Sectors because it helps to create business opportunities and combat pressure from competition.

The government of Tanzania initiated its first major attempt to promote the small industries sector as far back as 1966 with the formation of the National Small Industries Corporation (NSIC) under the National Development Corporation (NDC). The emphasis of the NSIC was to establish small industrial clusters, essentially training-production workshops, which in 1973 were taken over by the Small Industries Development Corporation (SIDO), and continue to operate. Development partners, donors, and NGOs have over the years influenced the regulatory reform processing creating the right regulatory framework and institutions, and developing sectoral policies and programs.

They have similarly implemented, and continue to implement, grassroots skills training and micro-finance programs to encourage income-generating activities.

There should appear that an inventory of these past and current Financial Sectors development initiatives have not been compiled, nor has there been a systematic effort to learn lessons from project assessment. This phenomenon has incomplete the exchange of “good practice” models and approaches. The Ministry of Industry and Trade report noted that efforts should be made to improve coordination between donors supporting the financial sector. Achieving coordination at the governmental level is also seen as a critical factor in improving the policy and program environment for financial sectors.

### 1.3 Strategic planning process and financial sectors

The strategic planning elements that are crucial for strategic planning are the vision, mission statement, objectives, strategies and action plans on financial sectors. The environmental scanning, employee participation in the strategic planning, time horizon of strategic planning, implementation incentives, evaluation and control, the formality of strategic planning and source of information about the environment was the key sources of strategic planning on financial sectors. The mission and vision are crucial elements of the strategic planning process on financial sector growth. The difference between vision and mission is in its time component; mission determines what the company does, whereas vision shows what the company will become and do in the future (Erambo *et al.*, 2016). Visions can be considered sources of energy for the achievement of formulated objectives. Vision, mission, and strategies are interconnected elements of an entrepreneurial perspective; together they turn the entrepreneur’s wish for a positive change into a managerial tool for the achievement of that change. Ambitious entrepreneurs who manage growth firms form an intensive and strong vision about the value they can create. Even if in a small firm the entrepreneur usually acts as a strategic manager taking all strategic and operative decisions (Oluoch, 2016), strategic vision forms a basis for strategy development and strategic planning.

In order for the firm to grow, the entrepreneur needs to formulate an exact, clear mission and vision for his or her firm (Alford and Greve, 2017). Subsequently, the company’s vision, growth will be strengthened by a strategic focus on market, growth, and profits. Indeed, the planning of corporate or business strategy needs to be centered on the market, product, and service (Karadag, 2015). Vision and objectives are the basis of strategies and strategic planning. For an entrepreneur, it is beneficial to have a clear vision, high and growth-oriented objectives, and a belief that he or she can achieve the objectives (Abosede and Luqman, 2014). In order to be successful and to grow, the firm needs to formulate high, optimistic, growth-oriented objectives (Abimbola and

Kolawole, 2017). Subsequently, the addition to growth objectives and other objectives (financial or non-financial, personal or non-personal) may play important roles in the actual achievement of small firm growth. Action plans on the other are the pathways or avenues that guide the entrepreneur on how to reach the set objectives. Hence, the action planning typically comprises deciding who is going to do what and by when and in what order for the organisation to reach its strategic goals.

#### 1.4 Problem statement

Financial management practices and growth is one significant topic in the field of entrepreneurship and Micro, Small and Medium Enterprises (MSMEs) sector development as evidenced by an increasing number of publications and studies on the topic. According to Flemming (2014), approximately 84% to 92% of MSMEs fail within 5-10 years. According to the Tanzania Economic Survey 2013, the performance of Tanzanian MSMEs is weak as demonstrated by the deterioration in growth rate from 4.3% in 2010 to 5.9% in 2013. Such a decline in growth leads to unemployment in Tanzania which as a result leads to social injustices and corruption (Farashah, 2013). Consequently, the behaviours to address the bimodal dissemination of an enterprise where 77% are MSMEs, 27% medium firms, and 28% Micro organisation is still an empirical matter (Atow-Zahir, 2012). Failure to organisation growth in the MSMEs sector has for long remained mysterious most especially in the developing countries' perspective where the SMEs occupy a large part of the economy (Neumann and Dul, 2005). Studies from developed nations like the USA, Japan, and Dubai find financial management practices and growth contribute enormously to MSMEs' poor business performance.

Past studies that have studied MSMEs among which Karimi *et al.*, (2010), found out that MSMEs are not performing to the desired expectations and if this situation is not addressed, then the MSMEs contribution to the growth is likely to be affected. Moreover, these studies had unresolved contradictions applicable to MSMEs thus, calling the study in a developing country background like Tanzania to be done and assist in establishing the relationship between financial management practices and the growth of MSMEs. Consequently, this study is significant not because it fills the gap, but also it sets out to address this gap knowledge.

Locally, studies on financial management practices that have been done include, Farashah (2013) who did research financial management practices and growth of MSMEs, while Altamony *et al.*, (2016) did research on selected financial management practices as well. None of these local studies has ever focused on financial management practices and growth in MSMEs in the whole of Tanzania. It is in this light

that the study investigate to fill the existing research gap by studying the Financial Management Practices and growth of MSMEs of Tanzania.

## 2.0 Objectives of the Study

### 2.1 General objective

The main objective of this study was to explore financial management practices and the growth of MSMEs in Tanzania.

### 2.2 Specific objectives

- To assess the effect of financial innovations of MSMEs of Tanzania.
- To establish whether investment activities affect the growth of MSMEs of Tanzania.
- To determine the effect of risk management practices of MSMEs of Tanzania.
- To find out the effect of working capital management of MSMEs of Tanzania.

## 3.0 Literature Review

### 3.1 Financial innovations

Financial innovation is the process of creating a commercial product from an invention (Paterson, 2009). The study discovered that financial innovation can distribute four types of reimbursements besides cash: brand, knowledge, ecosystem, and culture. But the most important reason for financial innovation in enterprises is to generate a profit. A firm makes a profit by the contribution of products or services at a lower cost than its competitors or by contribution distinguished products at premium prices that more than reimburse for the extra cost of differentiation (Smith, 2012).

Salum *et al.* (2017) attributed the emergence of new ideas for product innovations in MSMEs to entrepreneurs. Micro, Small and Medium Enterprises (MSMEs) very actively explored new product ideas and the most frequent way of achieving this included contacts with customers. Altamony *et al.* (2016) recognized demand positioned on the commercial by clients/customers, nearby working relationships with key important customers and close analysis of competitor products are the major drivers of innovation in MSMEs covered in four different countries like the USA, UK, Dubai, and France.

### 3.2 Investment practices

Investment practices can be defined as the redistribution of resources from being consumed today to create benefits in future organisation growth (Mori *et al.*, 2014). Micro, Small and Medium Enterprises (MSMEs) have to use assets to earn income or profit. Though it is no longer a negotiating society where goods and services were often more perishable, it is preferable, if not essential, to invest instead of keeping assets idle, so that more investments can lead to growing to compete alongside inflation and future uncertainties for the business growth. MSMEs must be able to respond more rapidly and professionally to global market signals to take advantage of investment opportunities and acquire the benefits of the global trading system. Although they want to be more competitive and higher productive goods and services in an organisation. However, effective organisational business support systems are required to improve more competitiveness and high productivity and growth of MSMEs. It is also observed that the development of an effective organisational business support system is a significant factor for the success of investment for capacity building business growth. Investing activities for organisation growth require business support agencies (including a financial organisation) and government support which are customer-oriented as well as demonstrated capability of penetrating the MSMEs sector.

Consequently, multinational enterprises are looking out for new markets and investments offer capable MSMEs the opportunity to pull out themselves to an international value chain through commissioning relationships. Though those that are incompetent to do so and organisations had progressively faced the danger of losing their existing markets. Although the competition within the developing global world for export markets, foreign investment activities and organisation resources are also intensifying. Against this backdrop of increased global competition, MSMEs associations, support institutions, and governments in transition and developing global countries have to adjust and adopt new organisation approaches as well as formulate new ways of working together to adoptive MSMEs competitiveness

### 3.3 Risk management

Risk management is defined by Maehr, (2008) in Baum and Wally (2003) as “the identification, analysis and economic control of those risks which threaten the assets as well as earning capacity building of an organisation”. Management of risk has explicitly or implicitly become an important part of a strategic planning component of the modernized organisation’s survival and development of the enterprises (Atow-Zahir, 2012). Though risk can be considered as the probability of

economic or financial gains or losses, as a significant consequence of the ambiguity associated with undertaking a course of action (Baum and Wally, 2003). Risk encompasses all human engagements, various categories of business organisation as well as every area of management of a company. Although, risk management can be more so predicted on the basis of experience, trying to better govern the disorder of an organisation business growth. Risk Management has the responsibility of identifying risks, and treating risks, determining the probability and the possible control of events, reducing or eliminating their effect with the minimum investment of resources for business growth. Risk Management is being more developed in business growth as well as globally adopted in a lot of fields within enterprise management.

In developed and developing countries all over the global world, MSMEs are considered significantly important to the growth of any organisation's economy. MSMEs require the adoption of a risk management strategy as well as a methodology because they lack the resources to respond promptly to external and internal threats, causing the potentially enormous losses that extremely threaten their survival.

Studies by the Wanjiku (2017) and the Chartered Accountants Institute in Wales and England coincidentally prove that the most significant risk among small businesses involves human factors. A large number of employee turnovers and a shortage of know-how experts both result in wastage of manpower and the additional cost of training. In the long term, the human factor will lower productivity and affect the brand image of small businesses as an employer (Richard *et al.*, 2009).

### **3.4 Working capital management**

The study was done by Mori *et al.* (2014) entitled “effects of working capital management and growth of MSMEs profitability in Spain” found a significant negative association between working capital management and MSME profitability. Invariance to the findings of Mori *et al.* (2014), the results from the study conducted by Altamony *et al.* (2016) indicate significant positive correlations between working capital business components with firms’ performance in Malaysia. Majama and Magang (2017) investigated the effects of working capital management and growth on the profitability of a sample of SMEs of Spanish firms. Consequently, the findings revealed that owners/managers can create value by reducing their inventories as well as the number of days for which their accounts are outstanding.



### 3.5 Performance and growth of micro and SMEs

Performance is one of the most important objectives of financial management growth because the goal of financial management is to maximize the owner's growth wealth (Mori *et al.*, 2014). Performance and growth are important in determining the failure or success of a business. At the initial stage, a business organisation may not be profitable because of investment activities and expenses for establishing the organisation's business in these MSMEs. When a business organisation becomes more mature, the organisation's profits have to be produced in an enterprise's growth. Due to the importance of performance, Baum and Wally (2003) among other researchers have suggested that small firms need to concentrate on performance and growth. Richard *et al.* (2009) found performance to be a significant determinant of a small firm's credit risk. Salum *et al.* (2017) stress the aim of a business organisation is not only the growth of sales but also the achievement of organisation profits. Profit is more important because it is the most required for the survival of the business of the organisation. Low performance contributes to under-capitalization problems due to retained earnings and therefore to be more confident in external capital (Richard *et al.*, 2009).

### 4.0 Data Analysis/Findings

#### 4.1 Regression analysis

This discussion of the results of inferential statistics has critically described here. The analysis used multiple regression analysis to determine the relative importance of each of the variables with respect to the financial management practices and growth of MSMEs. IBM-SPSS statistical package was used to enter and compute the measurements of the multiple regressions for the study. The summary of the findings are presented in Table 1.

**Table 1: Financial Management Practices (Model Summary)**

Model	R	R Square	Adjusted R Square	Std. An error of the Estimate
1	0.948	0.899	0.705	0.514
<i>Notes: a. Predictors: (Constant), risk management practices, investment activities, financial innovations, and working capital management.</i>				
<i>b. Dependent Variable: financial management practices and growth</i>				

For each variable, the coefficient in this study demonstrates the extent to which changes in the dependent variable can be demonstrated by the transformation in the independent variables as well as the percentage of variation in the dependent variable (financial management practices and growth of MSMEs) that is explained by all the 4 independent variables (risk management practices, investment activities, financial innovations, and working capital management) (Table 2).

This study independent variables which were studied, explain 89.9% of the variance in financial management practices and growth of MSMEs particularly in Dar es Salaam as represented by the  $R^2$ . This means that other factors not studied in this research contribute 10.1% of the variance according to the dependent variable. Hence, it is recommended that further research should be conducted to establish the relationship between financial management practices and the growth of MSMEs.

**Table 2: Financial Management Practices (Multiple Regression Analysis)**

Model	Unstandardized Coefficients	Standardized Coefficients		T	Sig.
	B	Std. Error	Beta		
1. (Constant)	3.310	0.790		6.548	0.005
Financial innovations	2.188	0.261	0.281	0.265	0.004
Investment activities	2.064	0.248	0.570	0.245	0.033
Risk management practices	1.443	0.551	0.326	0.176	0.003
working capital management	1.252	0.547	0.332	0.124	0.002

Notes: a. Predictors: (Constant), risk management practices, investment activities, financial innovations, and working capital management.  
b. Dependent Variable: management of financial practices and growth

The Analysis of Variance described that F critical value at level 5% of significance was 5.33, whereas the ANOVA which is the value of F calculated is greater than the value of ANOVA which is F critical (value = 86.0); as a result, it shows that the overall model of the study was significant (Table 3).

**Table 3: Financial Management Practices (Analysis of Variance)**

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	40.566	3	.374	86.0	.001
Residual	4.686	7	.366		
Total	43.353	11			

Notes: a. Predictors: (Constant), risk management practices, investment activities, financial innovations, and working capital management.  
b. Dependent Variable: financial management practices and growth

Since the significance is less than 0.05, so it is indicating that the predictor variables), explain the study variation in the dependent variable whereas financial management practices and growth of MSMEs. Consequently, if it could be observed that the significance value of F was larger than 0.05 then the independent variables would not explain the study variation in the dependent variable of the model.

The regression findings model

$$\hat{Y} = \hat{\beta}_0 + \hat{\beta}_1 X_1 + \hat{\beta}_2 X_2 + \hat{\beta}_3 X_3 + \hat{\beta}_4 X_4$$

The substitution of the regression equation becomes like this

$$\hat{Y} = 3.310 + 2.188X_1 + 2.064X_2 + 1.443X_3 + 1.252X_4$$

Where  $\hat{Y}$  is the dependent variable (financial management practices and growth of MSMEs),  $X_4$  is the working capital management,  $X_3$  is risk management practices,  $X_2$  is investment activities, and  $X_1$  is financial innovations.

According to the equation, taking all factors (financial innovations, investment activities, risk management practices, and working capital management.) constant at zero, financial management practices and growth of MSMEs will be 3.310. The data findings also show that a unit increase in financial innovations, variable will lead to a 2.188 increase in financial management practices and growth of MSMEs; a unit increase in investment activities will lead to a 2.064 increase in financial management practices and growth of MSMEs; a unit increase in risk management practices will lead to a 1.443 increase in financial management practices and growth of MSMEs, and a unit increase in working capital management will lead to a 1.252 increase in financial management practices and growth of MSMEs. The analysis concludes that the most significant factor is financial innovations as shown in Table 3.

#### 4.2 Performance and growth of MSMEs

From the analysis of findings, the respondents from the study strongly agreed with the statement that Performance is very significant in determining the failure or success of a business, in this case, MSMEs of Tanzania. Secondly, respondents agreed with the statement that the aim of a business is not only the generation of high sales as well as generation of profits which influences the performance and growth of MSMEs of Tanzania; Thirdly respondents agreed with the statement that Profit is especially important because it is necessary for the survival of a business, therefore, influencing performance and growth of MSMEs of Tanzania; finally, respondents indicated that Low performance contributes to under-capitalization problems because it leads to retained earnings as well as reliance on external capital which influences the performance and growth of MSMEs of Tanzania.

The study findings relate with literature review by Salum *et al.* (2017) who indicated that the aim of a business organisation is not only the generation of high sales as well as generation of profits for organisation growth. The study observed that profit is especially important. After all, it is necessary for the survival of a business organisation and Low performance contributes to under-capitalization problems because it contributes to retained high incomes and therefore to a dependence on external capital for the organisation's growth.

## 5.0 Conclusion

The study concludes that financial innovations influence the performance and growth of MSMEs of Tanzania to a very great extent and that is the reason for an organisation's innovation is to make a profit. Also, SMEs financial innovation is essential in order to develop long term stability of the business and that innovation requires the organisation to be competent in relating to current technology. The study concludes that the customer perspective of innovation demands a change in technology as well as consumer behaviour in an organisation to accommodate new product usage conditions in business growth.

Consequently, the study concludes that business investment can be demonstrated as the redirection of an organisation resources from being consumed today to creating benefits of organisation in the future; that It is significant to invest in an organisation so that investments can grow the enterprises to fight against inflation and future uncertainties and that development of an effective business organisation support system is also a key condition for the success of investment capacity building of an organisation, while investment requires business organisation support agencies which have a demonstrated capability of penetrating the MSMEs sector.

The study also concludes that risk management has become part of business strategic planning component of the modern organisation's survival and development of enterprises; that risk management can also be seen as the possibility of financial or economic losses or gains; that MSMEs require the adoption of an enterprises risk management strategy for business growth and methodology; and that the most significant risk among small businesses involves human factor.

Finally, the study concludes that there's a statistical significance between business working capital and organisation performance and growth. There is a highly significant negative relationship of an organisation between the time it takes for an enterprise to collect cash from their customers' development. Heavy business investment in inventory rising business capital which in the end decreases the

organisation's profitability. Also, in business growth, there is a need for compromise between organisation receivables and holding business inventory if the organisation is to achieve the required profits.

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