Effect of Financial Information Quality on the Performance of Small and Medium Enterprises in Ghana

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Abstract- Small and Medium Enterprises are considered an important part in the development of most business societies. They play a significant role in the growth and developmental process of most countries. The study explored the use of quality financial information by owner/managers in Ghana and how this impact on SMEs performance. A mixed method approach, employing both quantitative and qualitative research methodology were utilised. Face-to-face interviews, using questionnaires were employed to collect data from 500 owner/managers of SMEs in the metropolis. The study revealed that the path coefficient between financial information and performance provides statistically significant and positive results that confirm the hypothesis. In other words, quality financial information positively affects performance. Quality financial information improves the performance through access to external capital. The findings support the argument that when SMEs develops its ability to be investment ready, access to external capital would be enhanced. With an investment readiness mind-set, SMEs should be able to access funding to support and enhance business growth. It was therefore recommended that government should support SMEs and also develop programmes to enhance investment readiness amongst SME owner/managers.

Index Terms- Financial information, performance, SMEs

I. Introduction

Small and Medium Enterprises (SMEs) are increasingly seen as playing an important role in the economies of many countries especially in developing countries. Thus, governments throughout the world focus on the development of the SME sector to promote economic growth. In South Africa, SMEs contribute 56 percent of private sector employment and 36percent of the gross domestic product. They are of significant importance to the growth and development (Ntsika, 2002, Abor & Quartey, 2010).

Governments want people to start and grow firms and the requirements for start-up are minimal and depends on the business structure: a business or company name may need to be registered, a tax file number and an Australian business number may be needed (www.business.gov.au), and should the firm have sufficient turnover, then registration for goods and services tax (GST) would also be required. However, there are no legal requirements for nascent entrepreneurs to have any management skills; they only need a desire to be in business and a willingness to start trading. Yet management skills are critical to small firm survival (Storey, 1994) and the interest here is in the financial management aspect of operating a small firm. In particular, the question is: "What financial information is recorded within small firms and how is it used to inform business decisions?"

Information readiness is the ability to provide information intended to attract financial providers. Marsden Jacob Associates (1995) highlighted that a lack of investment readiness is primarily due to information failure. SMEs face difficulty in accessing finance because they do not have the track record that potential investors can rely on in making their investment decisions (Southon & West, 2006). Moreover, they do not know how to present themselves as attractive investment opportunities (Harding & Cowling, 2006).

Financial information allows financial providers to appraise business performance and thus reduce difficulties in accessing finance. This is because financial information enables financial providers to assess SMEs' ability to remain solvent, grow, and meet financial providers' requirements (KPMG Special Services & EIM Business & Policy Research in the Netherlands, European Network for SME Research, & Intomart, 2003). Financial information reduces information asymmetry by allowing financial providers to assess SME health and make sound decisions. This in turn reduces the risk of investment in SMEs. Therefore, information readiness in this study focuses on financial information, as it is crucial for attracting financial providers to invest in SMEs. The types of financial information are covered in the section below.

Financial information also takes the form of financial indicators, such as return on investment, return on assets, current ratio, and inventory turnover. These financial indicators are useful for measuring business health. They show the firm's strengths and weaknesses in terms of liquidity, profitability, and financial position. Carrington and Howitt (1983) described financial information as information that represents some real phenomena in monetary terms. This is consistent with the definition by Pearson Education (2005, p. 3), that financial information is "information which may be reported in money terms". Ratnatunga, Romano and Lourens (1993), Ingram et al. (1999) described financial information as the provision of information in financial terms which helps in making decisions about organisations. From these definitions, it can be concluded that an important aspect of financial information is that it provides useful information in monetary terms for business decision-making.

To be useful for decision-making, financial information must possess certain characteristics (Knapp & Kemp, 2003). Quality is an important characteristic of financial information. This is because quality ensures that financial information is reliable and useful. High-quality financial information allows owners/managers to appraise the financial health of their business and to answer questions such as, how quickly inventory is turning over, how much the firm owes, and when debts are due (Cunningham, Nikolai, & Bazley, 2000; Xu et al., 2003). In addition, quality financial information also enables smaller firms to detect problems before they become threats to their viability. Problem detection and correction are very important in the day-to-day management and operation of an enterprise (English, 2001). Quality is defined in several forms such as accuracy, relevance, reliability and timeliness.

Hughes (2004) indicated that timely and accurate financial information is important to owners/managers in making effective decisions. McMahon (2001) suggested that timely and relevant financial information is needed to monitor the firm's financial position and performance. Likewise, Wood (1989) observed that a key to the management decision-making process is the keeping of accurate financial information. From the above discussion, quality is clearly central to the characteristics of effective financial information. Having presented the types and characteristics of financial information, there is a need to understand how SMEs prepare and use this information to support their decision-making since this influence their ability to access finance and the performance of their businesses (Peacock, 2000). The purpose of this study was to assess the effect of financial information on the performance of SMEs in the Accra Metropolis.

II. Financial information and SME performance

In the absence of financial information, SMEs not only find it difficult to signal their value to financial providers when seeking finance, but also have trouble performing well. This is because, without financial information, SMEs do not have the means to control business activity, assess business performance, or plan for the future. Empirical evidence suggests that financial information is central to all business functions, forming the basis for corrective and preventive actions that improve organisational performance (Palmer, 1994; Peacock, 2000). Financial information provides all data on key operational matters necessary for protecting businesses from falling into a difficult situation before it is too late to recover (Hughes, 2004).

Therefore, businesses with solid financial information practices are more likely to perform better than businesses lacking these. Hughes (2004) argued that SMEs are unable to perform well by just being able to access finance, but that they need to have financial information to manage it. In other words, even if SMEs have sufficient finance, they may lose it simply because they do not have timely financial information on key operating matters that they can draw upon in making sound decisions. Financial information enables SMEs to make better decisions, plan more effectively, and avoid the many possible pitfalls businesses face.
Blackwood and Mowl (2000) examined the relationship between business planning/financial management and business performance, and found that businesses with better performance were likely to be operated by owners/managers who regularly prepared financial information. These results are consistent with the findings of Lussier (1995), Palmer (1994), McMahon and Davies (1994; 1992), all of whom highlight financial information as one of the important factors affecting SME performance. The influence of financial information on SME performance does not end with their preparation or maintenance; rather, it is dependent on their use for decision-making.

As such, financial information does not provide any benefits unless it is used as a management tool (Ingram et al., 1999). Though a majority of smaller enterprises prepare statutory financial information, very few use this information for decision-making. Potts (1977) noted that the use of financial information in decision-making provides the clearest and most striking distinction between small businesses with good performance and those with low performance. DeThomas and Fredenberger (1985) corroborate Potts' (1977) findings by demonstrating that businesses which did not use adequate financial information for financial controls had lower performance than firms that did.
This scenario may be understood in the light of the findings of Hodgetts and Kuratko (1998) and Ratnatunga and Dixon (1993), whose analyses indicate that financial information provides owners/managers with information vital to their businesses. Such information includes the profitability of past activities, their ability to meet liabilities and operating expenses, and the financial structure of the business in relation to current and non-current assets. Nevertheless, the benefits of using financial information depend on its quality. Intomart (2003), indicated that a competent assessment of SME economic and financial performance is based on high quality financial information. This is because such information gives an accurate picture of the true financial condition of the business.

In contrast to the findings of the above studies, a meta-analysis of 320 empirical studies conducted by Capon, Farley and Hoenig (1990) relating environmental, strategic, and organisational factors to financial performance failed to discover any definitive impact of financial information on financial performance. A similar outcome was reported in Thomas and Evanson's (1987) study of 398 small pharmacies in the United States. They were unable to demonstrate a significant association between the number and the frequency of use of financial information on one hand and SME performance on the other. They hypothesised that this might be due to a lack of ability on the part of owners/managers to interpret information properly.

Their proposition is supported by the findings of KPMG Special Services, and EIM Business & Policy Research in the Netherlands, European Network for SME Research, and Intomart (2003), and Williams (1984), that a lack of knowledge about financial information limits SMEs' ability to utilise this information to gain a competitive advantage. Financial information is expected to enhance access to finance. This is because firms with good financial information will face fewer barriers in raising external funds. Access to finance is expected to enhance performance of SMEs since it allows them to have more investment opportunities. Thus, if financial information impacts performance, and if access to finance enhances performance, then it is speculated that financial information will influence access to finance, which ultimately influence performance.

III. Research Methodology

The study area was the Accra Metropolis of the Greater Accra Region of Ghana, which covered a total land size of 200 sq. km. The target population for the study was all SMEs in the Accra Metropolis and the accessible population was defined as all manufacturing and trading SMEs which had registered with the National Board for Small-Scale Industries (NBSSI) in the Accra Metropolis as at July, 2010. The total number of businesses recorded in the NBSSI's register by location in the Metropolis was 3,474. The population was classified using the 11 sub-metropolis. Given that the population is 3,474, it was logical to determine a sample for the study. Sarantakos (2005) and Krejcie and Morgan (1970) consider that a sample size should be determined either by direct calculation using statistical formulas appropriate to the nature of the study or by reference to tables which set out recommended sample sizes for given populations.

Based on the table developed by Krejcie and Morgan (1975), with a population size of about 3500 and to ensure a 5 percent margin of error, the sample size should be 346. However, to ensure an increase in internal and external validity, a sample of 500 SMEs was selected for this study. Stratified sampling was used to select the sample from each sub-metropolis. Both primary and secondary data sources were used for the study. The data was collected through the use of questionnaire and focus group discussion guide. The instruments used in this study were questionnaires to owners and managers of SMEs and a focus group discussion for members of Ghana National Chamber of Commerce and Industry. The questionnaire consisted of both open-ended and closed- ended questions. Structural equation modelling using partial least squares was employed to test the hypotheses in this study

IV. Results and Discussion

The results from the descriptive statistics on business characteristics covering the form of business ownership, types of business, business areas, number of employees, and industry of operations based on the number of years. Of the 500 respondents, 280 were males representing (56%) and 220 were females representing (44%). The majority of the SMEs were sole proprietorship (91.8%), and a few of them were partnership (6.2%). 9 out of 500 SMEs were Companies representing (2%). The predominance of sole proprietorships over other legal forms of business may be due to the fact that they have fewer legal and tax requirements than partnerships or companies. Sole proprietorships provide owner/managers with independence in making decisions. SMEs in Accra Metropolis are male dominated (56%), also firms that were organised as companies were mostly male dominated. Out of 10 companies, 9 were male owed and only one was female owned. Thus, there were marked differences between males and females in the legal structure of business formation ($\chi 2$= 13.4108: p-value = 0.001).

Information readiness is measured by quality of financial information in terms of preparation of financial information, reasons for using financial information, and level of importance attached to information. Results in Table 1 show that 78.8 percent of businesses prepared financial information out of which 72.2 percent were in the trading sector.

Table 1: Preparation of financial information by the business type

Business Type	Prepare		Do not prepare		Total	
	F	%	F	%	F	%
Trading	361	72.2	104	20.8	465	93.0
Manufacturing	21	4.2	2	0.4	23	4.6
Service	12	2.4	0	0	12	2.4
Total	394	78.8	106	21.2	500	100.0

Source: Field data, 2015

Table 2 shows that 87.3 percent of the owners/managers prepared their own financial information. Other owners/managers used the services of an auditor (4.7%), part-time accountant (4.4%) and full-time accountant (3.6%). Most (80.9%) owners/managers who prepared their own financial information were from the trading sector.

Table 2: Persons who prepared the financial information by business type

Business Type	Owner		Part-time accountant		Full-time accountant		Auditor		Total	
	F	%	F	%	F	%	F	%	F	%
Trading	313	80.9	16	4.1	13	3.4	15	3.9	357	92.2
Manufacturing	14	3.6	1	0.3	0	0.0	3	0.8	18	4.7
Service	11	2.8	0	0.0	1	0.3	0	0.0	12	3.1
Total	338	87.3	17	4.4	14	3.6	18	4.7	387	100.0

n = 500, missing case = 113
Source: Field data, 2015

The purpose for preparing financial information is presented in Table 3. About 76.8 percent of the sampled owners/managers prepared financial information for profit purposes, 74.8 percent prepared financial information to check for the performance of the business, 60.8 percent for management purpose, and 24.6 percent for tax purposes.

Table 3: Reasons why owners/managers use financial information

Reasons	Yes	No	Total
Profit	76.8	23.2	100.0
Performance	74.8	25.2	100.0
Management	60.8	39.2	100.0
Tax	24.6	75.4	100.0
Support loan	5.4	94.6	100.0
Legal requirement	4.4	95.6	100.0

n = 500
Source: Field data, 2015

Owners/managers who prepared financial information were asked to indicate the level of importance they attached to various pieces of financial information. The responses are summarised in Table 4.

Table 4: Level of importance attached to financial information

Reasons	n	Mean	SD	CV	Minimum	Maximum
Income	500	3.95	0.76	0.19	1	5
Net profit margin	500	3.91	0.77	0.20	1	5
Cash flow statement	500	3.86	0.83	0.22	1	5
Inventory turnover	500	3.85	0.81	0.21	1	5
Budget	500	3.40	1.02	0.30	1	5
Aged debtor balance	500	2.41	1.08	0.45	1	5
Aged creditors balance	500	2.40	1.12	0.47	1	5
Balance Sheet	500	1.95	1.38	0.71	1	5
Return on equity	500	1.81	1.26	0.70	1	5
Return on Assets	500	1.79	1.23	0.69	1	5
Current ratio	500	1.61	1.21	0.75	1	5

Source: Field data, 2015

The respondents considered income and net profit margin as the most important forms of financial information, with mean indices of 3.95 and 3.91 and coefficient of variation of 19 percent and 20 percent respectively. The higher the coefficient of variation, the greater the dispersion in the variables (Sarapaivanich, 2003). These were followed by cash flow statement (3.86), inventory turnover (3.85) and budget (3.40). The respondents attached least importance to financial information on current ratio, return on assets and return on equity. These could be explained by the fact that financial information prepared by SMEs generally consisted of income statement and Statement of financial position. The income statement conveys the enterprise's revenue, expenditure, and net income (or net loss) for a specific time period, which is crucial for decision-makers.

The statement of financial position supplies information, which helps users to assess enterprise's ability to increase owners'/managers wealth and remaining solvent (Sarapaivanich, 2003). Inventory turnover had a mean index of 3.85 and this could be associated to the high level of education in this sector. Owners/managers made conscious efforts to manage inventory well since it sometimes formed greater percentage to their start-up capital. During the data collection process, a number of owners/managers indicated that they did not know or had never heard of other financial information like current ratio, return on asset, and return on equity. Some of them had never prepared other financial information apart from profit and loss statement and balance sheet.

Table 5: Path coefficient, *t*-statistics and *p*-values of financial information quality on performance using PLS

Path between Unobserved Variables	Path Coefficient	*t*-statistics	*p*-value
FI -> PERF	0.1274***	2.9557	0.0016

Table 5 shows the hypothesised relationships between the financial information quality and performance of SMEs using PLS. Financial information was predicted to be positively related to performance. The path coefficient between financial information and performance provides statistically significant and positive results that confirm this hypothesis. In other words, quality financial information positively affects performance. That is, access to accurate, important and timely financial information enhances owners/managers' satisfaction with their businesses on the various performance measures. This analysis indicates that, of the 11 types of financial information considered in this study, business stability and income to look after family are the most widely reasons for preparing financial information for decision-making by SMEs in Ghana. Hughes (2004) argued that SMEs are unable to perform well by just being able to access finance, but that they need to have financial information to manage it. In other words, even if SMEs have sufficient finance, they may lose it simply because they do not have timely financial information on key operating matters that they can draw upon in making sound decisions.

V. Conclusion

There is no doubt that SMEs are engines of growth in any economy. Growth in the economy through the contributions of SME can largely be achieved through proper, effective and efficient use of quality financial information. For any business, quality financial information was found to be important in pursuit of the performance goals of growth and profitability. Quality financial information improves the performance through access to external capital. The findings support the argument that when SMEs develops its ability to be investment ready, access to external capital would be enhanced. With an investment readiness mind-set, SMEs should be able to access funding to support and enhance business growth.

Lack of financial information and managerial competencies are also important reasons why the needed funds are not available to SMEs. Therefore, to improve access to external finance, there is the need for personal development by owners/managers of SMEs especially in the area of business and financial management skills through training. This also calls for training in proper record-keeping and effective use of information from financial records to make and support decisions for finance and to monitor the use of finance as well as financial information. Exposure to information technology resources that simplify the record-keeping process is also necessary.

Given the relatively low level of education among owners/managers, training needs and knowledge requirements should be met through highly participatory, innovative and material-less techniques. Peer group training should be encouraged. More flexible forms of skill training should be encouraged and made available to SMEs. Educational training system drawn by promotional institutions should incorporate SME long term growth and development. Institutions like the National Board for Small-Scale Industries, Business Advisory Centre, Association of Ghana Industries and consultants can play significant roles in this regard.

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