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Effect of Financial Management Practices on Profitability of Small-Scale Enterprise: Case Study Hawassa City Administration, Ethiopia

Desta Yohanes [1] Kenenisa Lemie Debela[2]&Woldemichael Shibru[3]

1. *Research Scholar, Department of Accounting and Finance, Jimma University*
2. *Assistant Professor, Department of Accounting and Finance, Jimma University*
3. *Assistant Professor, Department of Accounting and Finance, Jimma University*

Corresponding auther: Desta Yohanes

***Abstract**: Small-Scale Enterprises are very important to the economic growth and development of a country. SensibleFinancial Management Practices can help Small-Scale Enterprises to become profitable and stays in business for a long period of time. This study aims to examine theeffect of Financial Management practices on profitability of Small-scale Enterprise in Hawassa City Administration. Questionnaires were used to collect primary data while secondary data were collected from various documents. The surveyinvolves 116 Small-Scale Enterprise for empiricalexamination of fixed asset management practice, accounting information systems practice, capital budgeting management practice, working capital management practice and capital structure management practice of Small-scale enterprises.Descriptive, correlation and regression analysis were used to analyze the data. Results revealed that a good financial management practice is abackbone to Small-Scale enterprises profitability, success and expansion. Analytical finding revealed that, fixed asset management practices, accounting information system and financial reporting analysis, working capital management practices, and capital budgeting managementpractices have positive relationship with profitability; but capital structure management practices has negative relationship with profitability. Accordingly, policy makersare recommended to design supportivepolicy tosmall scale enterprisesas far as the variables are concerned.*

***Keywords**: Ethiopia, Financial Management,Hawassa City Administration, Profitability, Small Scale Enterprise.*

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I. Introduction

Small Scale Enterprises play significant roles economic development of nations by facilitating industrialization, reducing unemployment by creatinglarge scales of new jobs that and reduce poverty which in generalcontributes to the Gross Domestic Products. Small scale enterprises also contributes significantly to the economy through creating more employment opportunities, generate higher production volumes, increase exports and be introducing innovation and entrepreneurship skills. According to Okpa, Amat, & Keith, (2012) MSEs are a major area of concern for government and non-government organizations with an objective of unemployment reduction, income generation and equitable income distribution, import substitution, innovation, poverty alleviation. Derbie & Kassahun (2013) posited that small businesses are the driving force for the growth and development of the economies of many countries in the world including Ethiopia.It is also noted in various literatures that such contribution of the small scale enterprises to the economy become realistic only with effective financial management practice. Financial management practice for small-scale business generally concerned with procurement, allocation, and control of financial resources. It is used to ensure regular and adequate supply of funds to activities to ensure adequate returns to owners which, in, tern, depends on earning capacity, to make market price expectations shares of owners, and to ensure optimum capital budget utilization of whole activities. Financial management is the backbone as once the resources are procured, it should be utilized in effectivemanner at least cost, ensure safety on speculation.Zuzana& Matej (2007)indicated that careless or poor financial management practice has been identified as one of the reasons for small business failures. It has also been noted that failure to effectively discharge broad financial management Functions has contributed largely to the global financial crisis.

It is believed that broad-based economic growth is the main route to poverty reduction through employment generation. Currently, Ethiopia has prioritized on micro and small scale enterprises development for economic growth, employment generation and building an industrial economy. To this end, the Ethiopian government has designed a National micro and small scale enterprises development and promotion strategy which facilitates and paves the ground for the growth and development of the sector starting from 1997. The Council of Ministers approved the Federal Micro and Small Enterprises Development Agency (FeMSEDA) with the objective to support, coordinate and help institutions that provide support for the development and expansion of micro and small scale enterprises in Ethiopia" (FeMSEDA,2010). FeMSEDA establishes a working relationship with regional government organizations, regional agencies responsible for MSE development, NGOs, and the private sector.

The significant contribution of Small-scale enterprises to the Ethiopians economy, the potentials of the SSEs have not been exploited fully and this is a concern of all stakeholders in the economy. To utilize this emerging sector in an economy;effective financial management practice is mandatory. To this end the current research aims at investigating the effect of financial management practice mainly Fixed Asset Management (FAM), Accounting Information Systems (AIS), Capital budgeting management practice(CBMP), Capital Structure Management (CSM) and Working Capital Management (WCM) on theperformance of Small-scale Business.

II. Statement of the Problem

Financial management is the main paths to development of nations. Firmsregardless of their size require good financial management practice to achieve success. Specially, small scale enterprise's owners need comprehensive financial information to set their prices and select their vendors. So, financial management practice is essential; to plan for overall business growth, diversification of product lines, or to reach new markets. Effective financial management is a tool to show direction for future activities, adjust when needed, and help businesses to find best way during challenging times.Thus the success of business is the result of effective financial management practice. According to Ariyo (2005) financial management practice plays key role in increasing market value of business,leading towards growth and productiveness which, ultimately leads to overall success of the economy. To do so, the small scale enterprises are expected to be financially strong,solventand profitable Sunday &Solomon (2012).

There is variance in profitability, survival, and growth of small scale enterprises compared to larger firms and each accounts for special problems in financial management(Dumbu, 2014). Getahun(2016) indicate that poor financial management practice is one the significant factor that affects the overall performance. Small Scale Enterprises generally tend to be confronted with higher interestrates, as well as credit rationing due to shortage of collateral.

Previous studies conducted by Derbie & Kassahun (2013) and Dumbu, (2014) focused onevaluation of management practices and hindrances to the success of the financial management practices. Ngugi (2014) also focused on factors affecting the performance of small and medium scale enterprises. In addition, most of the previous studies focused on other countries and literatures related to the effect of financial management practice on profitability of small scale enterprises as far as the knowledge of the researchers is concerned is scarce. Few studies focused on Ethiopian case limited themselves to some specific aspects such as cash management, recivable management. To this end, conducting research to assess the effect of financial management practice on profitability of small scale enterprises is worth making and could narrow the literature gap. Unlike the previous studies, this study examine the effect of financial management practices specifically Fixed Asset Management (FAM) practice, Accounting Information Systems (AIS) practice, Capital Structure Management (CSM) practice andWorking Capital Management (WCM) practice on the performance of Small-scale enterprises in case of Hawassa city administration.

III. Objectives of the Study

1.1. General Objective

The main objective of this study is to investigate the effect of financial management practices on profitability of Small Scale Enterprises.

1.2. Specific Objectives

To examine effect of fixed asset management practice on profitability of SSEs
To examine effect of accounting information systems practice on profitability of SSEs
To examine effect of working capital management practice on profitability of SSEs
To examine effect of capital structure management practice on profitability of SSEs
To examine effect of Capital budgeting management practice on profitability of SSEs

IV. Literature Review

Financial management practice play significant role for economic development of nations. Financial management practice involves various aspects. But literatures emphasis onfixed assets management, accounting and financial reporting, working capital management, capital structure management, accounting information system and other as an important component of financial management practice.Fixed Asset Management practice includes assets, such as depreciation amount, retirements, lease information, repairs, and maintenance. The appropriate purchasing decisions are made;capital equipment generates profits for the organization whereas incorrect choices have disastrous results for the business, since such equipment may not be sold over the short term. Competition in the market due to globalization and technological innovations created the need for businesses to invest in different accounting information systems to meet changing needs of the business improve on current operations as well.Michel and Sylvie St-Onge(2005)also found that financial reporting and analysis as one of performance measurement positively influences firm profit andEnekwe(2015)also support the positive relation. Esmeray (2016) found positive relation between the use of accounting information system and profitability performance of firms. Working capital management is one of the component of financial management practice. Norah, Mbabazize, & Shukla(2015) found that suitable working capital management practices especially cash management practices and trade credit management practices to have significant positive relation with profitability of small business. Capital budgeting is the process of appraising and preference of businesses putting with the goal of increasing the value of owners. Literatures provide inconclusive result as far as relation between capital structure management and firm performance is concerned. For instance, Ong Tze San & Teh Boon Heng(2011)and Casmir & Anthony (2012)found that capital structure hasnegative relationship withprofitability of small businesses and medium business. On the other hand Al-Taani (2013) posited that capital structure is not a major determinant of firm performance. Norahet al., (2015)found that capital budgeting decision affects organization performance with regards to rate of growth, operating costs; cash outflow and share price maximization. In contrast, Essra'a (2016) found statistically insignificant relationship between corporations' capital budgets techniques and financial performance.Efficiency in financial management is important especially for production firms whose assets are mostly composed of current assets (Wachowicz, 2004). Scholars suggested that observed choices regarding liquidity will depend on firm's access to markets and the importance of future investments to the business. Thus, the liquidity and profitability of business has a direct relationship. In addition, Accounting Information Systems (AIS) practice and financial statement Reporting Analysis (FRA) practice are to providepolicy, system, and the tool to the effective performance of business (Muhindo, Kapute & Zhou,2014).Regina (2012) and Rathnasiri (2015)states thatconsideringfixed assets management is very important because itrepresents significant percentage of total asset of business. Similarlyfindings of Devaraj& Kohli (2003) a positive link between Information Technology usage and spending of firm-level performance. Accounting information system plays an important role in our economic and social systems especially in its management and great work it does in facilitating management decision-making process. However, it is worthy to note that it would take several years for firms to realize the benefits from adoption of Accounting Information System (AIS); moreover, one cannot simply rely a great deal on AIS (Wah, 2000).Financial ratio analysis significantly related to effective management of the business as well as the performance of firm (Adedeji, 2014).

V. Research Design and Methodology

This study employed a qualitative andexplanatory research design.Itinvolves a mixed research method; it focuses on collecting, analyzing, and mixing both quantitative and qualitative data in a study. So, the population of this study taken from 2008/2015/16 report total of 2316 SSEs in Hawassa city Addiministrationregistered in trade and industry department.

In this study, the sample was selected using stratified sampling technique by considering the SSEs in all sectors (i.e. manufacturing,construction, service, trade, and urban agriculture) as strata. The samples from each stratum were drawn by applying simple random sampling technique.

The sample size was determined using the formula given by Yamane (1967) in drawing an adequate sample size from a given population at 95% confidence level.

$$n = \frac{N}{1 + e^2 (N)}$$

Equation 1: Sample size

Where; n = sample size required for the study

N= Total population size

e = level of precision

Accordingly, $n = \frac{2316}{1 + (0.09)^2 (2316)} \approx 116$

After determining the sample size required for the study, the sample size of each sector (stratum) was determined in proportion to size of the stratum using Cochran, (1977) formula. Accordingly, 21 manufacturing, 42 of the construction, 28 of the services 17 trade and 8 of the urban agriculture were selected. The primary data was collected by enquiring the sampled SSEs Likert-scale questionnaire. A five-point Likert scale was used in the design of the financial management practice questions. The secondary data was collected from financial statements of each SSEs from enterprise department and revenue authorities of Hawassa city administration then calculate the average for each SSEs.Descriptive statistics, correlation and multiple regression analysis were used to analyze the data collected.The assumptions of classical linear regression were tested and there were no significant problem observed.

1.3. Model Specification

$\mathrm{ROA} = \mathrm{f(FAMP, AISP, FRAP, CSMP, WCMP)}$

$$\mathbf{ROA} = \boldsymbol{\beta_0} + \boldsymbol{\beta_1}\,(\mathbf{FAMP}) + \boldsymbol{\beta_2}\,(\mathbf{AIS}) + \boldsymbol{\beta_3}\,(\mathbf{WCMP}) + \boldsymbol{\beta_4}(\mathbf{CBMP}) + \boldsymbol{\beta_5}\,(\mathbf{CSMP}) + \boldsymbol{\varepsilon}$$

Where

ROAE = Profitability of SSEs

β_0 = constant

$\beta_{(1-5)}$ = coffecienet of the independent variables

ε = error term

FAMP= Fixed Asset Management Practice

WCMP= Working Capital Management Practice

AISP= Accounting Information Systems Practice

CBMP=capital budgeting management practices

CSMP= Capital Structure Management Practice

VI. Results and Discussion

1.4. Descriptive Statistics

Table1 presents the outcomes of the descriptive statistics for main variables involved in the model of this study. The mean, standard deviation, minimum and maximum value were reported.

Table 1: Table of Descriptive Statistics

	FAMP	AIS	WCMP	CBMP	CSMP	ROA
N Valid	116	116	116	116	116	116
Mean	3.82713	3.36312	3.44241	3.41678	3.63531	.17398
Std. Deviation	.818231	.823502	1.087169	.924701	.799235	.165137
Minimum	1.000	1.000	1.000	1.000	1.250	-.453
Maximum	5.000	5.000	5.000	5.000	5.000	.590

Source: Author construct from survey data, 2017

The result shows that the mean of all the proxies of financial management practice are greater than the average, indicating the fact that the respondents agree that all the independent variables in the study have significant relation with return on assets. The minimum and maximum values also indicated that the responses vary between the scales used in the questionnaire. The standard deviation of all independent variables'is near to mean revealing that there is reasonable deviation, which, further indicatesthat there is approximately very good experience in financial management practice.

1.5. Correlation Analysis

Table 2: Correlation Matrix of Dependent and Independent variables

Correlations							
		ROA	FAMP	AIS	WCMP	CBMP	CSMP
Pearson Correlation	ROA	1.000					
	FAMP	.599**	1.000				
	AIS	.685**	.527	1.000			
	WCMP	.722**	.469	.650	1.000		
	CBMP	.698**	.493	.615	.651	1.000	
	CSMP	-.325**	-.158	-.239	-.339	-.107	1.000

**. Correlation is significant at the 0.01 level (1-tailed).

Sources: Author Survey SPSS result, 2017

The first Pearson correlation coefficient was positive (r = 0. 599), indicating a strong positive relationship between Fixed Asset Management Practices and profitability. This indicates that, if appropriate purchasing decisions are made; capital equipment generates profits for the business whereas incorrect choices may have disastrous results for the business, since such equipment may not be sold over the short term. The second Pearson correlation coefficient was positive (r = 0. 685), indicating a strong positive relationship between AIS and profitability. The relationship shows that if businesses effectively apply AIS to SSEs and uses acceptable financial reporting &analysis system, it could hold up the SSEs' profitability. The third Pearson correlation coefficient was positive (r = 0.722), indicating a strong positive relationship between working capital management practice and profitability. This shows that working capital management is thebackboneofbusiness success. The fourth Pearson correlation coefficient was positive (r = 0. 698), indicating a strong positive relationship between capital budgeting practiceand profitability. The last Pearson correlation coefficient was negative (r = - 0. 325), indicating a weak negative relationship between capital structure management practice and profitability.

1.6. Regression Analysis

1.6.1. Model Summary

Table 3: Table of Model Summary

Model Summary [b]				
Model	R	R^2	Adjusted R^2	**Std. Error of the Estimate**
1	.832[a]	.693	.679	**.093584**
a. Predictors: (Constant), CSMP, CBMP, FAMP, AIS&FRA, WCMP				
b. Dependent Variable: ROA				

Sources: Author construct from survey data of SPSS result, 2017

The above table indicated that the five independent variables used in the studied explain 67.9% of the profitability of Small-scale Enterprises in Hawassa city admiration.

Singh (2007) categorize R^2in social and psychological science as above 75% is very good; between 50–75 % is good; between 25–50 % is fair and below 25 % is poor. Therefore, it can be said that the model is fit the see the effect of indecent over the dependent variable.

1.6.2. ANOVA (Analysis of Variance)

Table 1: Table of ANOVA

ANOVA [a]						
Model		Sum of Squares	Df	Mean Square	F	**Sig.**
1	Regression	2.173	5	.435	49.616	**.000[b]**
	Residual	.963	110	.009		
	Total	3.136	115			
a. Dependent Variable: ROA						
b. Predictors: (Constant), CSMP, CBMP, FAMP, AIS&FRA, WCMP						

Sources: Author survey SPSS result, 2017

From a result of Table 4 above, the significance (P-value=0.000) is less than 0.05. This indicated that the Overall Regression Model is significant indicating that the independent variables have the combined significant effect on the dependent variable which is financial management practices on the profitability of Small-scale Enterprises.

1.6.3. Coefficients of Multiple Regression Analysis

Regression Coefficients are used for prediction, in multiple models to construct confidence intervals for a mean response and prediction intervals for a future observation(Gujarati, 2003)and (Weisberg, 2005).

Table 2 : Multiple Linear Regression Coefficients

Coefficients [a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	**Sig.**
		B	Std. Error	Beta		
1	(Constant)	-.341	.069		-4.931	.000
	FAMP	.042	.013	.209	3.239	.002
	AIS	.039	.015	.194	2.531	.013
	WCMP	.041	.012	.268	3.330	.001
	CBMP	.051	.014	.287	3.760	.000
	CSMP	-.026	.012	-.124	-2.171	.032
a. Dependent Variable: ROA						

Sources: Author survey SPSS result, 2017

The effect estimation result of the study revealed that there exist a significant and positive relationship between fixed asset management and profitability of Small-scale Enterprises in Ethiopia, Hawassa city administration with a regression coefficient of 0.042, t-statistics of 3.239and p-value of 0.002. This is to mean

that an increases in fixed assets management practice by1% increase ROA by 4.2 %. The result of this study consistent with preceding findingas Regina (2012) and Rathnasiri (2015)who found asignificantly positive association between fixed asset management practices and profitability of Small-scale Enterprises.
The finding further revealed that with a regression coefficient of 0.039, t-statistics of 2.531and p-value of 0.013 there is a statistically significant positive relationship between accounting information system and profitability of Small-scale Enterprises.

The estimated coefficient of working capital management practices with a regression coefficient of 0.041, t-statistics of 3.330 and p-value of 0.001 the regression results show that there is a statistically significant positive relationship between in Working Capital Management Practices and profitability of Small-scale Enterprises significant. More specifically, when working capital management practice increases by 1% then the ROA will increase by 4.1 %.

With regression coefficient of 0.051, t-statistics of 3.76 and p-value of 0.000, the results show that there is a statistically significant positive relationship between Capital Budgeting Management Practices and profitability of Small-scale Enterprises significant. For this reason, the results are reliable with the hypothesis of the study. The result further indicates that when capital budgeting management practice increases by 1% then the ROA will increase by 5.1%.

Finally, the coefficient of -0.021, t-statistics of -2.171and p-value of 0.032 shows that there is a statistically significant negative relationship between capital structure management Practices and profitability of Small-scale Enterprises significant. The finding support earlier empirical evidences as;Casmir & Anthony (2012),Al-Taani, (2013)Rathnasiri, (2015) and Getahun (2016) who posited that capital structure and profitability has anegative relationship with small businesses to medium business.

VII. Conclusion

From the output of the research it can be concluded that financial management practice mainly the fixed assets management practice, accounting information systems and practice, financial reporting analysis practice, andworking capital management practiceaffect the profitability of small scale enterprises and hence, management of such enterprises is advised to take these factors in account so as to assure the long-term survival of such enterprises.

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