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Financial Management Practices and Innovative Performances of the Nigerian SMEs Sub-Sector: A Conceptual Approach

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Abstract

Purpose: The role of small and medium-scale enterprises (SMEs) in economies all over the world is well established as a vital propeller of economic growth and other macroeconomic balances. Thus, the growth of SMEs has been at the center of scholarly debates since the last decade, with many factors including financial management practices as well as innovative practices, contributing to the extensive study of the performances of SMEs. However, with unpopular arguments in literature in the context of financial management practices and SMEs' innovative performances, this study attempts to explore how prudent financial management practices could inform SMES' innovative performances.

Methodology: Being a conceptual paper, the methodology adopted is explorative in nature, where literature was extensively explored in line with the research aim and specific study objectives.

Findings: The outcome of the explorative literature study revealed that financial management practices are important determinants of SMEs' innovative performances. This shows that working capital management, investment appraisal and analysis, financial information system management, financing and capital structure management are practices that SMEs must incorporate to foresee and take advantage of innovative opportunities that will lead to innovative performances

Unique Contribution to Theory, Policy and Practice: This conceptual paper adds fresh arguments to the existing literature on financial management practices, innovation, and SMEs' performances by hypothesizing a positive relationship between different financial management practices (particularly, working capital management, investment assessment practices, financing and capital structure management, as well as financial information system management) and the innovative performances of SMEs. Thereby, we are ushering in a gateway for new empirical studies on the phenomenon of financial management practices and innovative performances of

SMEs. In addition, SMEs' owners and manager can leverage on the implications of this study to inform practical decisions on various financial management practices.

Keywords: *SMEs, innovative performances, working capital management, financial information system, financing and capital structure management, and investment appraisal systems*.

INTRODUCTION

In all of the world, the economic importance of small and medium-sized enterprises (SMEs) is enormously demonstrated in every nation's economy (Rathnasiri, 2015; Mohammed et al., 2020). Some of the salient economic contributions adduced to the subsector are employment generation, GDP, export promotion, indigenization, utilisation of local raw materials, tax revenue, regional development, and a base for industrial growth (Safiriyu, 2012; Osotimehin et al., 2012; Abanis et al., 2013; Kamau & Assumpta, 2015; Anangwe & Malenya, 2020; Mbanugo et al., 2020). Research evidences from Africa, Asia, Latin America, Europe, and even the United States over the years have also maintained the status quo. Some of the recent studies, such as Mohammed et al. (2020) in Africa, point out that over 50% of the continent's economic growth is due to the subsector. Similarly, it is argued that in Asia, the subsector accounts for over 31% of the Malaysian GDP, 60% of that of China, and 43.5% of that of the US economy (Mohammed et al., 2020; Better Accounting, 2020). The European economies are not left out, as the subsector accounts for 58% of the EU GDP (European Commission, 2023). Their overwhelming contributions to economic growth are owed to the fact that they form the largest proportion of enterprises in every economy, and worldwide, they constitute over 90% of global enterprises (World Bank, 2023).

Accordingly, due to their integral positions, nations, regional economic blocs, and governmental heads have continued to prioritise SMEs growth and developments over the years with different schemes and programmes directed at SME performances (Hussain et al., 2011). Furthermore, researchers and scholars alike have consolidated the priority over the years with numerous research attempts and evidences to support SMEs sustainability (Hasanat et al., 2020; Adam & Alarifi, 2021; Mohammed & Suleiman, 2022; Chima, 2022). Thus, different phenomena have been studied consistently over the years in connection to SMEs in order to provide feasible solutions to impediments to the subsector, which are incessant due to the dynamism of both the domestic and international business environment. One of such phenomena that have immensely been studied in relation to SMEs yet still attract significant research interest is the concept of financial management practices, which is conceptualised from working capital management, investment appraisal, accounting information systems, financial reporting and analysis, and financial planning and control practices and often studied in relation to SMEs financial performances (Wolmarans & Meintjes, 2015; Kilonzo & Ouma, 2015; Muneer et al., 2017; Bismark et al., 2018; Adda, 2020; Lemi et al., 2020). However, SMEs often face strong competition among themselves, bigger enterprises, and foreign enterprises alike, which makes the market structure for SMEs operations highly competitive (Agwu & Emeti, 2014; Ismail et al., 2014; Bhoganadam et al., 2017). Perhaps, innovativeness can be an advantage for dynamic SMEs operators according to Ismail (2017).

Interestingly, the continual changes in the internal and external frameworks of enterprises, such as the micro- and macro-political, economic, and technological environments, mean that SMEs must embrace innovations and as well as incorporate innovative performances in their strategic plans to foster their sustainability and grease their integrality in the global economy. This conceptual paper attempts to argue that perhaps the innovative performances of the SMEs sector in Nigeria can be achieved through effective financial management practices by probing the extant literature to conceptualise the relationship between financial management practises and innovative performances.

Statement of the Problem

Scholars have argued that many factors substantially exert desired effects on SMEs innovative performances, and entrepreneurial orientation is one of such factors (Sirivanh et al., 2014; Hussain et al., 2015; Sahoo & Yadav, 2018; Hearlinawati et al., 2019; Mansi, 2021). Thus, since effective financial management practises reflect elements of entrepreneurial orientation, it is plausible to state that these practises could also exert specific effects on the innovative performances of firms that engage in them. This is because it is essential for firms to own and manage assets, opportunities, as well as financial structures and processes that guarantee their continual performances. However, such claims have not been elucidated by conceptual, empirical, or theoretical literature, thus creating a gap that this study intends to fill conceptually.

Objectives of the Research

i. To examine the relationship between working capital management and innovative performance.
ii. To examine the relationship between investment management practices and innovative performance.
iii. To examine the relationship between financial information systems and innovative performance.
iv. To examine the relationship between financing and capital structure management and innovative performance.

LITERATURE REVIEW

Small and Medium Scale Enterprises (SMEs)

According to Heskin et al. (2010), agencies saddled with overseeing the activities of small and medium-sized enterprises in individual countries have evolved with different definitions of SMEs in consonance with evolving economic conditions. Thus, definitions of SMEs have always revolved around economic dynamics, but nevertheless, common metrics used by all and sundry in the definition and distinction of SMEs have been the number of employees, annual turnover, and initial capital outlay. The European Union's view of MSMEs as of 2020 is given below.

Table 1

EU SMEs Definition

Businesses	Employment	Turnover	Total Assets
Micro	<10	£2,000,000	£2,000,000
Small	<50	£10,000,000	£10,000,000
Medium	<250	£50,000,000	£43,000,000

Source: EU, 2020

Similarly, in Nigeria, the Bank of Industry has until now defined the concept as follows:

Table 2

BOI SMEs Definition

Businesses	Employment	Turnover	Total Assets
Micro	<10	≤₦20,000,000	≤₦5,000,000
Small	>11≤50	≤₦100,000,000	>₦5,000,000 ≤₦ 100,000
Medium	<250≤200	≤₦500,000,000	>₦ 100,000 ≤₦5,000,000

Source: Bank of Industry, 2023

Financial Management Practices (FMP)

Financial management is simply one of the components of management and thus reflects the management act of organizing, controlling, planning, and executing financial activities in an enterprise with the ultimate aim of realising both the financial and non-financial goals of the enterprise (Kilonzo and Ouma, 2015). According to Abanis et al. (2013), the definite goal here is to achieve entrepreneurial objectives in the business. These practises are known to be integral to the survivability of SMEs since they also imply obtaining the financial resources required to finance the operationalities of an enterprise to achieve the desired operational outcome, bearing in mind the best cause of action among competitive alternatives (Bismark, 2018; Mohammed et al., 2020). In this literature review, the concept is conceptualised from four constructs: financial information systems, investment appraisal and management, working capital management as well as finance and capital structure management.

Working Capital Management Practices (WCMP)

Working capital management and current assets are interwoven since current assets connote enterprise assets that are readily convertible to liquid assets within a short period of time, usually twelve calendar months, while working capital connotes the financial resources invested in current assets, thereby demonstrating the short-term financial health of an enterprise in the course of its day-to-day operations (Somathilake & Pathirawasam, 2020; Mohammed & Suleiman, 2022). In addition, it reinforces the act of ensuring an optimal balance between the current assets and liabilities of a business through prudent strategies, and its management practises are essential for covering the management of accounts payable and receivable, cash, as well as inventories (Makori & Jagongo, 2014). The goal is to realise optimal return on assets and payment of liabilities (Yogendrarajah & Jeyan, 2017).

Investment Appraisal Practices (IAP)

This essentially connotes capital budgeting activities that generally affect the financial standing of an enterprise, notably the assets, since it reflects the long-term investment commitments of a business enterprise, which are usually large (Graham et al., 2014) cited by Somathilake and Pathirawasam (2020). According to Agbude (2013) and Kwarbai et al. (2020), it requires taking cognizance of potential investments, probing investment opportunities, making decisions among competitive options, and consequently monitoring to satisfy shareholder’s interests. Financial resources committed in the outlay of an enterprise with the goal of expectable returns are known as investments (Somathilake & Pathirawasam, 2020). The payback period method and internal rate of return are some of the most widely adopted metrics for investment appraisal, and it's established in the literature that these practises are critical to strategic decision making as a lot of success factors are dependent on them (Ejoh et al., 2016; Wambua & Koori, 2018).

Financial Information Systems (FIS)

The collection of information, mechanisms, and tools that dependably articulate and address difficulties that impend the performance outcome of enterprises is an act of financial information system (Al-Dalaien & Khan, 2018). A lot of business needs are reliant on accounting information embedded in a financial information system (Somathilake & Pathirawasam, 2020). Such systems incorporate accounting documents that are resourceful for peculiar business needs. The financial information system is intended to document the financial operations of an enterprise in harmony with set procedures (Trabulsi, 2018). These practises are often common among SME operators in western and other developed civilizations.

Financing and Capital Structure Management Practices (FCSM)

Effective capital structure management is another essential component of financial management practise because enterprises' sources of finance may be internal or external, according to Graham et al. (2014). The external source could be creditors such as banks, thrift stores, friends, and shareholders. On the other hand, an internal source may be feasible through reinvestment of retained profits in the cause of operations (Graham et al., 2014). Thus, the act of effectively and efficiently managing these sources of finances to realise the financial objectives of an enterprise is known as capital structure management (Somathilake & Pathirawasam, 2020).

Innovative Performances (IP)

Different definitions of innovative performances all fall around common metrics, such as the capability of introducing something new into an existing market in a competitive fashion, such as new products and services (Zhang & Chen, 2014). Management scholars like Khali et al. (2013), Akinwale et al. (2017), Kim-Soon et al. (2017) and Bigliardi et al. (2020) acknowledged it as an act of proposing new products and new programmes that aid in the production of new commodities and improvements on existing commodities, as well as the strength to adapt to a dynamic business environment. Thus, the definition entirely rests on the novelty of commodities. Going further, Gunday et al. (2011) defined it as the aggregate performances of a business enterprise, which are adduced to the introduction, renewal, and improvement of activities within processes, structures, and the products of an enterprising venture. According to Gunday et al. (2011), Khali et al. (2013), and Alzuod et al. (2017), measurements of innovative performances relate to firms' capacity to adapt strategically to changing business environments, their ability to provide new commodities and modify existing ones, the volume and quality of new commodities, as well as their ability to introduce them ahead of competitors. In addition, the number of new machines put in place for new commodities, the volume of innovations in line with patents, and the proportion of new commodities in the production line all must be considered.

Theoretical Foundation

Open Innovation Theory (OIT)

The advent of open innovation has endeared itself as a new paradigm in management research, with several scholars proposing scientific research-based evidence to support innovativeness in businesses and organisations alike (Osman & Abbas, 2016). Prior to this paradigm shift, firms were reliant on "closed innovation," in which internally invested knowledge through R&D acts as the driver of innovation, and it yielded desired outcomes such as increase in sales margins until the arrival of the 21st century, which saw large firms leverage the model to create barriers for smaller firms, also losing ground in innovative performances (Chesbrough, 2003). Scholars attribute the shortcomings of the closed innovation model to the high cost of technological advancement, which inflated the internal cost of actualizing innovation projects in an enterprise (Jang et al., 2006). For instance, it became challenging for enterprises to maximise profits due to the shortfalls in the lifecycle of new products. In addition, the 21st century is characterised by globalization, which has brought mobility in labour and several other benefits, such as knowledge dissemination, so that internally dependent innovation in a competitive business environment is no longer feasible and economical, thus forcing a paradigm shift to what is now known as an "open innovation model"(Jankovic & Golubovic, 2019; Fernanedez et al, 2019).

The open innovation model revolves around technological exploitation and technological exploration, being that it involves promoting innovativeness internally as well as supporting the external use of innovation through the conscious use of inflows and outflows of innovation insights (Fertsch et al., 2017; Grilo & Moreira, 2022). To put it in a more concise manner, it connotes the simultaneous and inverse sharing of innovation knowledge between the internal firm and external firms (Amposah & Adams, 2017). This model reflects aspects of the study phenomenon, such that for SMEs to effectively realise desired development using internal ideas, they must effectively adopt and engage in relevant practices, one of which is efficient financial management practices. For instance, SMEs' finance and capital structure may be sourced from external credit environments such as banks, which reflects the exploitation dimension of the open innovation model. In terms of exploration, financial management practises reflect accounting information systems, which record large amounts of transactional data with customers. These transactional data can provide insights on market trends, and research-based knowledge can be drawn from these accounting information systems to foster market, product, and process innovations. In conclusion, proponents of this theory have also maintained that insights from customers could provide a good factor for internal innovation processes (Gassmann, 2006; Von Hippel, 2005; van de Vrande et al, 2009).

Working Capital Management Practices and Innovative Performances

Liquidity and asset management are components of working capital, and it is plausible that their mismanagement may alter the financial strength of an enterprise, such as through threats of bankruptcy, which in turn may affect innovative conceptions such as modifications of existing commodities or the quality of new products introduced to the market. Supporting these arguments, Muneer et al. (2017) specifically concluded that working capital exerts a significant and positive influence on firms' performances. They reinforced the need for entrepreneurial managers to reconcile working capital management as a strategy to the renewal of administrative structures to navigate through the dynamic business environment. Fasesin et al. (2017) maintained that mismanagement of working capital acts as a bane for managing innovation-driven projects. In a literal sense, the actualization of a firm's strategic objectives may be dependent on the propensity of liquidity at its disposal. Thus, when a business desires to invest in innovative projects and activities, the more cash at its disposal, the closer it gets to its innovative goals and, consequently, innovative performances.

H1: *There is a relationship between working capital management and SMEs innovative performances*.

Investment Appraisal Practices and Innovative Performances

Investments must be evaluated and appraised for viability; hence, capital projects aimed at innovation activities, whether product, market, organization, or process innovation, must be reviewed for their viability to attain desired innovative performance. Business operators must possess the requisite knowledge, skills, and abilities to effectively evaluate investment opportunities using appropriate appraisal techniques before investing their scarce funds. Scholars have asserted that a significant number of enterprises in developing nations lack the KSAs to appraise investment projects, and this failure could explain the counterproductive investment decisions that strained performance (Agbude, 2013; Junjuan and Zhengqun, 2020). Interestingly, one can argue that these investment appraisal practises may help SME operators become acquainted with the feasibility of available innovative projects and determine the best alternative course of innovative action to harmonise with the strategic needs of the enterprise. This will inevitably sustain innovative performances.

H2: There is a relationship between investment appraisal practices and SMEs innovative performances.

Financial Information Systems and Innovative Performances

While this is widely associated with enterprises in developed nations, such practises are limited in developing nations to a few enterprises, for legal purposes. This is because there is no proper financial recordkeeping to begin with. Few studies have pointed out that drivers of innovative performances in enterprises, among several other things, incorporate operational functionalities and software systems. Several studies have maintained that the financial information system is a strong determinant of firms' performances if judiciously utilised (Olukayode et al., 2017; Malait et al., 2017; Somathilake & Pathirawasam, 2020). Perhaps such could also spawn innovative ideas and projects and ultimately influence innovative performances within an entrepreneurial venture. This is because these accounting systems generate insightful knowledge that aids smooth managerial functioning by collecting and processing transactional data. Since these systems have been acknowledged to support non-financial performances by Budiarto (2014) and Ironkwe and Otti (2016) cited by Somathilake and Pathirawasam (2020), they are therefore obtainable in terms of innovative performance. Also, Beg (2018) has further reaffirmed that FIS aids organisational growth in all ramifications and is used to improve product quality, process management, cost management, and decision-making. Conclusively, Ironkwe and Otti (2016) revealed earlier that the quality of service delivery among deposit money banks in Nigeria is attributed to their FIS. Improvement in service delivery is a component of process innovation and may be attributed to it; hence, FIS improves innovative performances.

H3: *There is a relationship between financial information system management and SMEs innovative performances*.

Financing and Capital Structure Management and Innovative Performances

Efficient capital budgeting arrangements enable enterprises to sustain operations by overcoming financial constraints (Kilonzo & Ouma, 2015; Palacios et al., 2016). An empirical study revealed that active credit sources are positively related to innovative projects in firms (Asiedu et al., 2021). Active credit channels promote firms' productivity through innovation (Janz et al., 2003). Similarly, in an empirical study in the DR Congo, it was established that the availability of external finance sources such as financial and non-financial institutions exerts positive influence on enterprise-initiated innovative projects (Asiedu et al., 2021). A study in Uruguay revealed that efficient capital structure management, reflected by high internal efficiency (good management of retained earnings), influences the degree of business expansion and innovation projects (Cassoni & Ramada, 2010). Thus, product innovation and process innovation in manufacturing firms were dependent on increases in capital structure from external sources. Furthermore, in the UK, Wakelin (2001) maintained that internal finances influence firms' investments in research and development. While in Germany, Gallego et al. (2015) found that innovative tendencies for firms increase when there is a huge capital outlay for research and development. However, since external financial sources and investors are less likely to commit resources to firms' R&D, enterprises could leverage retained profits to invest in R&D. This could mean that effective management of the capital structure of an enterprise provides the internal finances that can be reinvested in innovative programmes to facilitate innovative performances. Fernadez (2017) also argued in support of these propositions.

H4: There is a positive relationship between finance and capital structure management and innovative performances of enterprises.

Conceptual Model Establishing Financial Management Practices as Factors for SMEs Innovative Performances

From the literature review, it is logical to propose that the SMEs subsector in Nigeria is a challenging one when it comes to achieving sustainable performance, and this is because the business environment is never static, and hence competitive SMEs operators must prioritise innovative performances strategically through prudent and innovative financial management practices in order to fulfill both short-term and long-term financial objectives. These practices include working capital management, investment management, financing and capital structure management, and financial information system management.

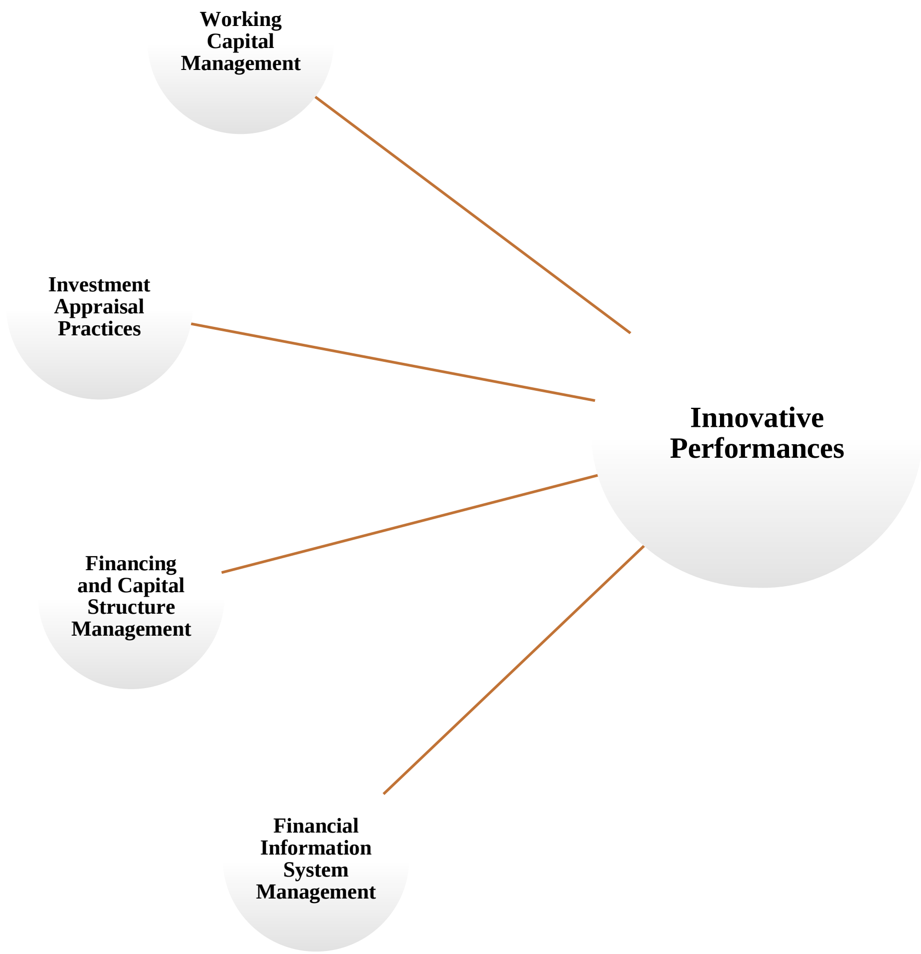

Figure 1: The Link Between Financial Management and Innovative Performances

Looking at the conceptual model in Figure 1, one can argue that working capital management, investment appraisal management, finance and capital structure management, as well as financial information system management, exert influences on the innovative performances of SMEs.

Conclusions

Findings maintain that innovative performances depend on a number of financial management factors. The arguments articulated in this conceptual paper demonstrate insights on the deterministic relationship between financial management practises and SMEs' innovative performances. This knowledge will provide the basis for empirical research on the phenomenon. It is the delight of this conceptual paper to support literature development by providing scholars with a reference point. In addition, it is hoped that these arguments will exert an impact on SME operators and policymakers in terms of formulating and implementing good financial management practices.

Limitations and Suggestions for Further Research

Being a conceptual paper, it lacks an empirical base; hence, it is expected that an empirical study be done on the nexus between financial management practises and SMEs' innovative performances to provide robust findings that would aid policy recommendations.

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