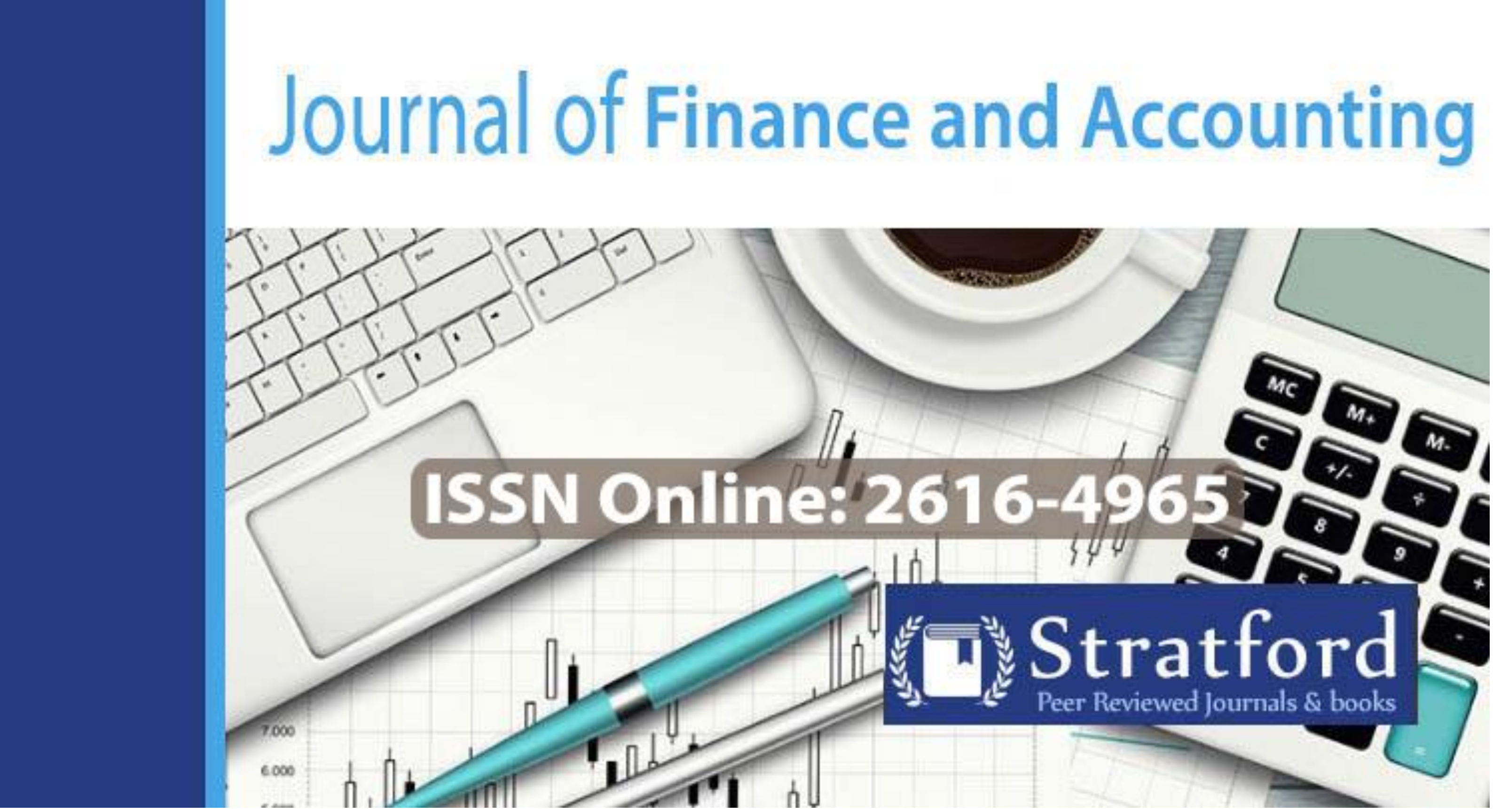

Effect of the Management Accounting on the Financial Performance of Small and Medium Enterprises in Rwanda: A Case of Small and Medium Enterprises in Gasabo District

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Effect of the Management Accounting on the Financial Performance of Small and Medium Enterprises in Rwanda: A Case of Small and Medium Enterprises in Gasabo District

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Abstract

Management accounting provides an excellent opportunity for companies to compete in the market by offering superior products and services at reasonable prices to customers. The general objective of this study was to study the effects of management accounting practices on the Financial Performance of Small and Medium Enterprises in Gasabo district, Rwanda. This study adopted a correlation study design. The target population for this study was the 171 small and medium enterprises in Gasabo district Stratified random sampling method was applied to come up with the sample size, since the population in different Small and Medium Enterprises was considered heterogeneous, implying that a simple random sample is unrepresentative. The study therefore involved 171 Small and Medium Enterprises in Gasabo district. The study collected primary data from the respondents. The data collected was both quantitative and qualitative. Qualitative data is descriptive and non-numerical, while quantitative data is numerical. The study found that Budgeting was the most widely used management accounting practices, including budgeting for planning, activity-based budgeting, flexible analysis, zero-based budgeting, and budgeting for controlling costs. costing systems were the second most widely used management accounting practice, including separation of variable, incremental, and fixed costs; plant-wide overhead rate; activity-based costing; target costing; and cost of quality. Information for decision making was also used by respondents, including stock control models, customer satisfaction analysis reports, product profitability analysis reports, risk analysis reports, and investment analysis reports. Strategic analysis was also highly used by respondents. The study further concludes that the most important elements of management accounting practices amongst the Small and Medium Enterprises in Gasabo district are; the management accounting function identifies key factors that influence Financial Performance and management accounting practices have increased return on equity (ROE), which is a measure of how profitable a company is for its shareholders. This is because management accounting practices help companies to identify and improve risky areas, which can lead to increased profits. This study recommends the creation and enhancement of awareness among firms of the importance of Information for decision making practices as this is the most highly used management accounting practice amongst the Small and Medium Enterprises in Gasabo district.

Keywords: *Management Accounting Practices, Costing Systems, Budgeting, Information for Decision Making, Strategic Analysis, Financial Performance, Small And Medium Enterprises*

1.0 Introduction

Management accounting (MA) aims to increase the awareness of how a business is performing and thus help attain better business Financial Performance. While small and medium sized business organizations (Small and Medium Enterprises) comprise the majority of companies, with remarkable business potential, a significant amount of research on MA focuses on larger organizations (Armitage et al., 2021; research on MA in the Small and Medium Enterprises context is currently fragmented, spanning various research fields, including accounting, entrepreneurship, management and production and operations management (Lavia Lopez & Hiebl, 2020). Small and Medium Enterprises account for 99.8% of enterprises in the European Union (European Commission, 2019) and 99.9% in the UK (UK Parliament, 2021), while employing approximately 67% (in EU) and 61% (in the UK) of the working population. Small and Medium Enterprises represent a remarkable potential for employment, growth and business renewal in Europe. To successfully compete with larger organizations, and to take part in contemporary business networks, the SMEs' scarce resources need to be very effective. Modern information and controlling systems can help managers make better decisions by providing them with data. However, many companies are not using these systems to their full potential among SMEs (Pedroso and Gomes, 2020). Large variation in the organizational size of Small and Medium Enterprises significantly influences MA needs (Lavia Lopez & Hiebl, 2020).

Even though management accounting systems have been thoroughly researched in big businesses and small and medium-sized businesses (SMEs), there are still not many studies on Financial Performance. (Sooraboyen & Poorundersing, 2022). Furthermore, as stated by several scholars, the results obtained for larger companies and those belonging to different sectors may not be significant. In the context briefly outlined, this paper focuses on Small and Medium Enterprises in Gasabo, Kigali/Rwanda to assess the effect of management accounting on business Financial Performance. We chose this geographical area because it has the strongest economy and is the most competitive, as measured by turnover, tourist presence, international investments, and employment.

1.1 Problem statement

Small and medium enterprises (SMEs) are the backbone of Rwanda's economy, contributing significantly to employment generation and GDP growth. In Gasabo District alone, SMEs represent 80% of the total businesses, playing a crucial role in the local economy. Despite their importance, many SMEs in Gasabo District struggle to achieve optimal financial performance, with 75% reporting challenges such as limited access to finance, inefficient resource allocation, and inadequate strategic planning.

One key determinant that could potentially address these challenges is the adoption and effective utilization of management accounting practices. However, there is a noticeable lack of empirical research examining the impact of management accounting on the financial performance of SMEs within the unique context of Gasabo District. Understanding the relationship between management accounting practices and financial performance is imperative for devising tailored strategies to address the specific needs and challenges faced by SMEs in the region.

By investigating the effect of management accounting on the financial performance of SMEs in Gasabo District, this research aims to fill this gap in the literature. Through a comprehensive analysis of SMEs in the district, including their management accounting practices, financial indicators, and other relevant variables, this study seeks to provide valuable insights into the mechanisms through which management accounting influences financial performance.

The findings of this research will not only contribute to the academic literature but also offer practical implications for policymakers, business owners, and other stakeholders. By identifying effective management accounting practices that positively impact financial performance, policymakers can design targeted interventions to support SMEs in Gasabo District. Likewise, business owners can leverage these insights to enhance their decision-making processes, resource allocation strategies, and overall performance, thereby fostering the growth and sustainability of SMEs in the region and contributing to the broader economic development goals of Rwanda.

1.2 Research objectives

The general objective of the research is to establish the effect of management accounting on the Financial Performance of Small and Medium Enterprises in Gasabo District, Kigali/Rwanda.

The study will be guided by the following specific objectives:

- To determine the effect of costing systems on the Financial Performance of SMEs in Gasabo.
- To assess the effect of the budgeting on the Financial Performance of SMEs in Gasabo.
- To establish the effect of information for decision making on the Financial Performance of SMEs in Gasabo.
- To establish the effect of strategic analysis on the Financial Performance of SMEs in Gasabo.

1.3 Research hypotheses

The study intends to evaluate the validity of the flowing hypotheses:

H01: Costing has no significant effect on the Financial Performance of SMEs in Gasabo.

H02: Budgeting has no significant effect on the Financial Performance of SMEs in Gasabo.

H03: Information for decision making does not have significant effect on the Financial Performance of SMEs in Gasabo district.

H04: Strategic analysis does not have significant effect on the Financial Performance of the SMEs in Gasabo.

2.0 Literature Review

2.1 Theoritical framework

This section provides theories and research studies that explain how the management accounting influences the business Financial Performance. These theories include contingency theory, resource-based view theory, tactical management accounting model, Financial Performance management theory, organizational learning theory, and business intelligence theory. All these theories and their references are all applicable to this study. They assisted the researcher to analyze and interpret the collected data, in order to link them with the general views assessed below:

2.1.1 Contingency Theory

Contingency theory explores how the design and implementation of the management accounting practices can impact business Financial Performance in different organizational contexts. It suggests, there is no universal approach to management accounting that suits all organizations, but rather the effectiveness of the management accounting practices depends on

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the unique characteristics and contingencies of each organization, (Kamisah, et all, 2018). Key aspects of contingency theory and its relationship with management accounting and business Financial Performance include fit between MA Systems and organizational context. Contingency theory highlights the importance of aligning management accounting systems with the specific characteristics of an organization, such as its size, industry, technology, and strategy. The design and implementation of management accounting systems should be tailored to match the needs and goals of the organization to maximize Financial Performance. It also includes flexibility and adaptability. Contingency theory recognizes that organizations operate in lively and indeterminate airs.

Management accounting systems should be flexible and adaptable to respond to changes in the internal and external factors affecting the organization. This flexibility enables organizations to adjust their accounting practices and systems in line with changing circumstances, thereby improving Financial Performance. It also supports in providing quality information and decision making. Effective management accounting provides accurate, relevant, and timely information to support decision-making processes. Contingency theory accentuates the importance of aligning the information provided by management accounting systems with the specific needs of decision-makers in the organization. Decision-making processes are enhanced when management accounting systems provide information that is aligned with the unique requirements of the organization's decision context. Furthermore, Financial Performance measurement and control. Management accounting practices show a vital role in Financial Performance measurement and control within organizations.

Contingency theory suggests that Financial Performance measurement systems should align with the organization's strategic goals and provide appropriate measures that reflect the specific needs of the organization. Effective Financial Performance measurement and control systems facilitate goal achievement and overall business Financial Performance. Overall, contingency theory recognizes, there is no one-size-fits-all approach to management accounting. The effectiveness of the management accounting is contingent upon the unique characteristics and contingencies of each organization. By considering the fit between the management accounting and business context, organizations can enhance their decision-making processes, adapt to changing circumstances, and ultimately improve business Financial Performance.

2.1.2 Resource – Based – View (RBV) Theory

The Resource-based View (RBV) theory, in the framework of management accounting, examines how the allocation and utilization of resources through management accounting practices can impact business Financial Performance. The resource-based view (RBV) theory proposes that a firm's competitive advantage and Financial Performance are determined by its unique and valuable resources and capabilities, (Research Gate, 2019).The resource-based view (RBV) theory emphasizes the importance of strategic resources for a firm's competitive advantage and Financial Performance. Strategic resources are those that are valuable, rare, difficult to imitate, and non-substitutable. Management accounting practices can help firms identify, assess, and allocate their strategic resources effectively. It also includes Financial Performance measurement and incentives. Management accounting provides Financial Performance measurement systems and incentives that align with the firm's strategic resources and goals. By measuring and rewarding Financial Performance related to the effective utilization of strategic resources, management accounting can motivate employees and improve overall business Financial Performance.

Moreover, cost efficiency and value creation. Management accounting practices, such as cost accounting and cost management techniques, help in achieving cost efficiency and optimizing resource utilization. By identifying areas of waste, reducing costs, and enhancing value creation through efficient resource allocation, management accounting can positively impact business

Financial Performance. Furthermore, strategic decision making. Management accounting information plays a vigorous part in strategic decision-making processes. It provides insights on the financial inferences of different strategic options, investment decisions, and resource allocation choices. By supporting informed and data-driven decision making, management accounting can contribute to improved business Financial Performance.

RBV will influence management accounting by identifying and assessing resources and capabilities, tracking the Financial Performance of resources and capabilities, allocating resources and capabilities to different activities, and monitoring the costs of resources and capabilities. With RBV in management accounting, managers can gain a better understanding of the firm's resources and capabilities, and use this information to make fine decisions around the firm's Financial Performance.

2.1.3 Organizational Learning Theory

Organizational Learning theory examines how management accounting practices can facilitate and enhance learning within an organization, ultimately impacting business Financial Performance. It recognizes the importance of knowledge acquisition, sharing, and application to improve decision-making, problem-solving, and overall organizational effectiveness. Key aspects of Organizational Learning theory and its relationship with the management accounting and business Financial Performance include:

Knowledge Acquisition: Organizational Learning theory highlights the importance of management accounting in acquiring and generating relevant knowledge. Management accounting provides information on Financial Performance, costs, profitability, and other key metrics that contribute to organizational knowledge. By collecting and analyzing this data, organizations can gain insights into their operations and make informed decisions to improve business Financial Performance. It also includes information sharing and communication. Management accounting supports the sharing and communication of monetary and non-monetary info within the organization. Through reports, dashboards, and presentations, management accounting facilitates the dissemination of knowledge across different levels and departments. This sharing of information promotes organizational learning by enabling individuals and teams to access and utilize valuable insights for decision-making and problem-solving. In addition, it includes feedback and reflection. Management accounting practices play a crucial role in providing feedback and facilitating reflection within the organization. Financial Performance reports, variance analysis, and other management accounting tools provide feedback on Financial Performance outcomes, enabling individuals and teams to reflect on their actions and outcomes. This feedback loop encourages learning from successes, failures, and areas for improvement, leading to enhanced business Financial Performance. It also includes decision Support.

Management accounting provides decision support by offering relevant and timely information for decision-making processes. By combining data from different sources, such as accounting systems, customer relationship management (CRM) systems, and enterprise resource planning (ERP) systems, to provide a more complete and holistic view of a business's Financial Performance., management accounting enables managers to make informed decisions that align with organizational objectives and enhance business Financial Performance. This includes investment decisions, pricing strategies, resource allocation, and cost management. Moreover, it includes Financial Performance evaluation, learning and continuous improvement. Organizational Learning theory recognizes the importance of Financial Performance evaluation as a catalyst for learning. Management accounting contributes to Financial Performance evaluation by providing Financial Performance metrics, benchmarking data, and analysis of variances. Through this evaluation, organizations can identify areas for improvement, learn from past experiences, and implement changes to enhance business Financial Performance (Brooks, 2022).

In summary, Organizational Learning theory highlights the importance of the management accounting practices in facilitating knowledge acquisition, sharing, and application within an organization. By providing relevant information, supporting decision-making, enabling feedback and reflection, and promoting continuous improvement, management accounting enhances organizational learning and ultimately impacts business Financial Performance. It supports effective decision-making, drives process improvements, and fosters a culture of learning and adaptability within the organization.

2.1.4 Business Intelligence Theory

Business Intelligence (BI) theory examines how management accounting practices contribute to the effective use of data and information to improve business Financial Performance. It focuses on collecting, examining, and evaluating data to extract meaningful information and make informed decisions that drive organizational success, (Jonathan, 2021). Key aspects of Business Intelligence theory and its relationship with management accounting and business Financial Performance include: Data Collection and Integration: Business Intelligence relies on the collection and integration of data from distinct sources, including management accounting systems. Management accounting provides financial data, cost information, Financial Performance metrics, and other relevant data that form the foundation of business intelligence. By integrating this data with other sources, organizations can gain a comprehensive view of their Financial Performance and make data-driven decisions. It also includes data analysis and reporting. Business Intelligence involves analyzing facts to recognize drifts, patterns, and insights. Management accounting provides the necessary tools and techniques for data analysis, such as financial analysis, variance analysis, and Financial Performance reporting.

By leveraging management accounting data within business intelligence systems, organizations can generate meaningful reports and dashboards that provide actionable insights for refining business recital. In addition, it includes Financial Performance monitoring and measurement. Business Intelligence theory recognizes the importance of monitoring and measuring Financial Performance to track progress towards organizational goals. Management accounting practices play a vital role in providing Financial Performance metrics and indicators that are utilized in business intelligence systems. By monitoring key Financial Performance reviews derived from management accounting data, businesses can recognize areas of under Financial Performance, take corrective actions, and improve overall business Financial Performance. Moreover, it includes the decision support, predictive analytics and forecasting, and continuous improvement and optimization.

In summary, Business Intelligence theory recognizes the importance of management accounting in providing data, analysis, and insights that fuel business intelligence initiatives. By leveraging management accounting data within business intelligence systems, organizations can improve decision-making, monitor Financial Performance, anticipate future trends, and drive continuous improvement. This integration of management accounting with business intelligence enhances data-driven decision-making and ultimately impacts business Financial Performance.

3.0 Research Methodology

The study adopted correlation design in order to collect and interpret data. Therefore, both quantitative (questionnaire) and qualitative (interview) research techniques were used by the researcher in order to collect data (information) related to the objectives of the study and for data analysis. The target population of this study was 300 SMEs in in Gasabo District. A total of 171 Small and Medium Enterprises in Gasabo are found in the research, based on the sample size calculated using the Solvin formula presented above. Both primary and secondary data sources were utilized, with primary data collected through questionnaires and key informant interviews. Secondary data were obtained through a documentary review process.

The research instruments were tested for validity and reliability. Questionnaires, as a primary data collection method, were designed to align with the research objectives, utilizing a mix of close-ended and open-ended questions, primarily based on a Likert scale. Documentary review supplemented the primary data collection process, enhancing the depth of information acquired. For reliability, the Cronbach's alpha values for various variables were calculated, all surpassing the acceptable threshold of 0.7, indicating strong internal consistency. Editing, coding, and tabulation processes were employed to ensure data quality, consistency, and organization.

Data analysis involved Statistical Package for Social Science (SPSS V 21.0) for quantitative analysis. Inferential statistics, including Pearson correlation analysis and multiple regression analysis, were conducted to establish relationships between Management Accounting and the Financial Performance of Small and Medium Enterprises in Rwanda. Ethical considerations were a priority, ensuring confidentiality by avoiding the disclosure of respondents' identities and maintaining strict confidentiality of sensitive information throughout the study.

4.0 Findings

This section shows the findings of this research by presenting it from analysis. Where this is required, interpretations are provided after each table, always taking into consideration the initial research questions. This section thus establishes the ground up on the research questions were answered before drawing conclusion. The analysis was made on the responses obtained from 171 Small and Medium Enterprises in Gasabo.

4.1 Regression Analysis

Regression analysis is the statistical technique that identifies the relationship between two or more quantitative variables: a dependent variable, whose value is to be predicted, and an independent or explanatory variable (or variables), about which knowledge is available. The technique is used to find the equation that represents the correlation between variables. Multiple regression analysis is a statistical technique that can be used to predict a single variable (dependent variable) from two or more other variables (independent variables). It is used to model the relationship between the variables and to determine how much of the variation in the dependent variable can be explained by the independent variables.

The study adopted multiple regression guided by the following model:

$$Fpt = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + e$$

Table 1 shows the regression model summary results where R square, adjusted R square, and std. error of estimates are presented.

and standard error of estimate are presented.

Table 1: Regression Analysis

Model	*R*	*R Square*	*Adjusted R Square*	*Std. Error of the Estimate*
R Square	.794	.642	. 633	.4228

Source: (Field data, 2023)

In the table 1 indicated management accounting practices had a joint significant effect on Financial Performance of SMEs in Gasabo district as shown by r value of 0.642. The R squared

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of 0.794 shows that the independent variables accounted for 79.4% of the variance on Financial Performance of SMEs in Gasabo district.

The findings of this study provide strong evidence of a positive relationship between management accounting practices and the Financial Performance of small and medium-sized businesses (SMEs) in Gasabo district.

Table 2: ANOVA

ANOVA

	df	SS	MS	F	Significance F
Regression	1	0.007621	0.007621	0.029391	0.864085
Residual	169	43.81975	0.259288		
Total	170	43.82737			

Source: (Field data, 2023)

The results in Table 2, the regression model is statistically significant (f=78.391; p= .008 < 0.05) at 5% level of significance. Therefore, since the p-value is less than 0.05, it is woth to conclude that the multiple linear regressoin model used for this study is appropriate in predicting (fits) the outcomes significantly well.

Table 3 Displays the coefficients, t-values, and p-values for the independent variables in the model.

Table 3: Correlation Matrix

Elements	**Financial Performance of SMEs**	**Costing systems**	**Budgeting**	**Information for decision making**	**Strategic analysis**
Financial Performance of SMEs	1				
Costing systems	.631	1			
Budgeting Information for decision making	.527	.432	1		
Information for decision making	.762	.341	.487	1	
Strategic analysis	.872	.523	.513	.718	1

Source: (Field data, 2023)

* Correlation is significant at 0.5 level

** Correlation is significant at 0.01 level.

Table 3 presents the correlation matrix illustrating the relationships between the Financial Performance of SMEs and various management accounting factors, namely Costing systems, Budgeting, Information for decision making, and Strategic analysis. The table reveals that there are significant positive correlations between the Financial Performance of SMEs and each of the management accounting factors. Specifically, there is a strong positive correlation between Financial Performance of SMEs and Strategic analysis ($r = 0.872$, $p < 0.01$), indicating that SMEs with better strategic analysis tend to have higher financial performance. Moreover, Financial Performance of SMEs also shows a strong positive correlation with Information for decision making ($r = 0.762$, $p < 0.01$) and Costing systems ($r = 0.631$, $p < 0.01$), suggesting that effective decision-making information and costing systems positively influence SMEs' financial performance. Similarly, there is a moderate positive correlation between Financial Performance of SMEs and Budgeting ($r = 0.527$, $p < 0.01$), indicating that proper budgeting practices contribute to improved financial performance among SMEs in Gasabo District, Kigali/Rwanda.

Overall, the correlation matrix provides valuable insights into the relationship between management accounting practices and the financial performance of SMEs, highlighting the importance of strategic analysis, information for decision making, costing systems, and budgeting in enhancing SMEs' financial performance.

5.0 Conclusion

The budgeting was the most widely used management accounting practice among small and medium-sized businesses (SMEs) in Gasabo district, followed by costing practices, information for decision making, and strategic analysis. The study also found that the most important elements of management accounting practices for SMEs in Gasabo district are: Raising money in larger amounts at a cheaper cost than they could elsewhere, Developing strategies that enable SMEs to exploit financial information innovations in creating sustainable competitive advantage, Providing techniques that are used to manage risk exposures, Identifying key areas that require improvements, and Creating the cultural values necessary to achieve the organization's strategic objectives.

6.0 Recommendations

In the data analysis and interpretation as shown in above discussion, the study sought to come up with the following recommendations: zsThe study recommended the raising awareness of the importance of budgeting practices among firms, as this is the most widely used management accounting practice among SMEs in Gasabo district. Also, integrating value-based measures, such as return on equity, return on assets, and earnings per share, into the measurement of Financial Performance. Additionally, management accounting professionals should keep abreast of research findings in their field to remain relevant and add value to the companies they work for and their profession. Furthermore, accounting curricula should be developed consistently with accounting policies. Accounting education should equip students with the capabilities to cope with the rapidly changing business environment so that they can always provide relevant management accounting information to managers. Moreover, academics and practitioners can use the findings of this study to fully understand how management accounting practices can help to improve business Financial Performance in companies.

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