

## **FINANCIAL MISMANAGEMENT OF SMALL BUSINESSES: A STUDY BASED ON THE HOTEL INDUSTRY IN NUWARA ELIYA DISTRICT**

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### **Abstract**

*The purpose of the study was to identify the financial mismanagement of small businesses and their effect on the business's success. This research used the qualitative approach and continued the study through the general qualitative method. Sample were selected based on the purposive sampling method. Accordingly, data collection was done through in-depth interviews with owners of six small businesses in the Talawakele - Lidula Municipal Council area in the Nuwara Eliya District. The data were analysed, and themes were derived using thematic analysis. The main mismanagement identified from the study was mismanaging start-up capital, cash flows, budgetary system, personal spending, retained earnings, and working capital. Due to these mismanagements, businesses cannot run with a proper plan. The findings of this study will enable small businesses to identify their financial mismanagement. These findings will also help policymakers to identify the areas that are required to improve the financial management literacy of small business owners.*

**Keywords:** Financial Mismanagement, Qualitative, Small Businesses, Hotel Industry

**JEL Classification:**

### **1 Introduction**

A small business is typically a privately owned entity, such as a corporation, partnership, or sole proprietorship with fewer employees and generates less annual revenue than more giant corporations or standard-sized businesses (Berisha & Pula, 2015). This definition holds in a general sense. In Sri Lanka, small businesses are defined explicitly as enterprises employing between 11 to 50 individuals and having an annual turnover ranging from 16 to 250 million LKR (National Policy Framework for Small Medium Enterprise Development, 2021). Small and medium-sized enterprises (SMEs) in Sri Lanka are crucial in driving economic growth through their substantial contributions to job creation, fostering entrepreneurship, and promoting innovation (Vermoesen et al., 2013). Sri Lanka boasts a robust community of over 500,000 entrepreneurs operating within the SME sector, and these enterprises collectively account for approximately 45% of the country's GDP. This data underscores the significant

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economic impact of SMEs in Sri Lanka, particularly since the inception of the Open Economic Policy in 1977, which marked a turning point in the sector's growth.

Barringer et al. (2005), briefly highlighted a significant contrast within the business landscape; while most businesses experience modest growth, with an average increase of 3.5% in the USA, there are exceptional cases known as "Gazelles" that achieve annual sales growth exceeding 80%. This disparity underscores the varying trajectories of businesses. According to estimates provided by the Asian SME Summit (2009), more than 75% of SME start-ups face significant challenges that lead to failure within the first five years of operation. This issue is not unique to any nation; it is a global phenomenon. The United States, for example, also witnesses similar trends, although the exact percentages may vary from one country to another. The repercussions of high SME failure rates are substantial. They pose a considerable challenge to entrepreneurial societies as they can hinder wealth creation, impede overall economic growth, and limit employment opportunities.

Additionally, such conditions discourage individuals from pursuing entrepreneurship and push them toward more stable, salaried positions in the public and private sectors, which are perceived as less risky. Turyahikayo (2015) corroborated these findings by confirming that approximately 50% of all small businesses end their operations before reaching their second anniversary. This premature closure can be attributed to various issues, including insufficient capital, inadequate managerial skills, reliance on outdated technology, a decline in competitiveness within the market, financial mismanagement, and a lack of supportive entrepreneurial policies (Gamage, 2003).

Financial management is central to any enterprise, constituting the backbone of small business management systems (Meredith, 1986). Despite the universal goal of increasing profits, many small business owners often need to pay more attention to the significance of a robust financial management process (Eniola & Entebang, 2017). The financial management process is essential for success in small businesses (Hiadlovský et al., 2016). Nevertheless, it is a recurring issue that small businesses frequently mismanage their finances, resulting in premature failure. Consequently, small business proprietors must proactively recognize these financial mismanagement pitfalls and comprehend their detrimental impacts on the overall success of their enterprises (Lewis, 2015).

Conversely, the downfall of small businesses is frequently attributed to their struggle with financial management. More proficiency in financial management can lead to substantial challenges in SMEs' financial and overall performance, ultimately resulting in a high rate of

business failures (Hall & Young, 1991). Various factors contribute to this phenomenon, including a lack of financial support, inadequate training, subpar bookkeeping and record-keeping practices, limited financial management experience, issues related to corruption, and deficient infrastructure (Okpara & Wynn, 2007). Moreover, a critical shortcoming of small businesses is their failure to generate adequate accounting and financial information, which is crucial for stakeholders in making informed financial management decisions (Perks, 2010). In summary, effective financial management plays a pivotal role in determining the survival and success of small businesses. Due to the facts mentioned above, the researchers' objective is to explore the financial mismanagement of small businesses in the hotel industry.

This present study adopts a qualitative research methodology to delve into the financial management systems of small businesses. The primary focus of this research is to gain a comprehensive understanding of this subject within a specific context without the intention of generalizing the findings. The remainder of this article is structured into several sections: a literature review, theoretical review, methodology, data analysis, discussion, and conclusion. Each section serves a distinct purpose in achieving the goals of this study. The literature review presents the current state of knowledge regarding financial management, while the theoretical review delves into the specific financial management practices within small and medium-sized enterprises (SMEs). The methodology section outlines the research approach used. Data analysis summarizes the research findings, shedding light on the insights gained. In the discussion and conclusion section, The study's findings were compared to existing literature, and potential avenues for future research were identified.

## **2 Literature Review**

The fundamentals of entrepreneurial finance are derived from both entrepreneurship and finance. To generate prospects, launch commercial endeavours, and create value, new businesses need financial resources. Investors anticipate receiving compensation for the use of their money as well as for the chance that they won't get it back. It is best to develop a successful entrepreneurial venture without sacrificing one's morals or reputation (Leach & Melicher, 2009). Previous studies suggest that some factors can similarly influence the growth and success of small firms. Access to and managing financial resources are often critical factors affecting the ability of small businesses to implement growth opportunities (Fadahunsi, 2012). According to Jindrichovska (2013), liquidity management and cash flow management, long-term asset acquisition and funding, capital structure, and cost of funding

are the main three elements of financial management. The most critical question is the liquidity management. If a company is unable to develop a suitable policy to manage its working capital successfully, the company will never see success in the long term. Typically, the fundamental factor underpinning SMEs' issues is the inadequate financial management of owner-managers (Francis et al., 2023).

Small businesses mainly raise capital from the owner's savings and the savings of the owner's immediate friends and family (Anangwe & Malenya, 2020). They have solid financial needs and access to intermediate finance, such as bank loans in the growth stage, and face severe financial constraints related to operational requirements and business expansion. Though currently constrained sources, most new businesses will also use financial bootstrapping or innovative strategies, like barter, to reduce the money required to fund the business. Financial bootstrapping limits the need for outside cash and locates distinctive funding sources for a new business (Alvarado & Mora-Esquivel, 2020). However, most small businesses fail due to poor business capital management (Wu & Song, 2008). In addition, small business owners, especially from rural areas, have insufficient knowledge of banking services and loan procedures. Due to the lack of understanding, those businesses cannot obtain funds for long-term survival and growth (Bbenkele, 2007).

Most small businesses need to care about their working capital position. They have little regard for their working capital position, and most do not even have a standard credit policy (Sunday, 2011). Working capital is the difference between a company's short-term assets and liabilities. It measures a company's liquidity, short-term financial health, and operational efficiency (Fernando, 2021). Small firms have a weak financial position; thus, they rely on credit facilities to finance their operation, and most of the time, credit facilities are obtained from the accounts payable. Poor liquidity in most small businesses has short-term assets to cover short-term liabilities, leading to a shortage of funds. Many small businesses' highly inadequate bookkeeping system reduces their ability to maintain the proper flow of working capital. The low level of working capital flow has precluded small businesses from their ability to compete effectively (Sunday, 2011).

Similarly, cash flow management is the main factor for a small business entity's short- and long-term survival (Adda, 2020). Businesses need to maintain proper cash flow. Many businesses operate without maintaining financial records and any knowledge of small business management. Cash is the lifeblood of an entrepreneurial venture. Without sufficient cash, a venture dies (Leach & Melicher, 2009). Further, restrictions on loans and poor debtor

repayments play a role in small businesses' adverse cash flow performance. Without reasonable cash management procedures, the business is less likely to be profitable, grow and be productive (Mungal & Garbharran, 2011). Uwonda (2013) has found out that tax planning, preparation of cash flow statements, income statements, and balance sheets, and determining and interpreting financial statements as the main challenges to cash flow planning faced by small business owners.

Budgeting is also a significant factor in the day-to-day activities of any business. Poor budgeting management or poor understanding of budgeting contributes to the failure of the small businesses (Mbutia & Omagwa, 2019). The formal budgeting process positively impact on the performance of SMEs, where the firms engaged in more formal budgeting planning have achieved a higher growth rate in the sales and profit (Mulani et al., 2015). However, lack of top management support and qualified personnel are the two main factors that hinder the management of budgets (Maduekwe & Kamala, 2016). Many small businesses fail since they fail to review their expenses and spending habits related to the budget reports. Moreover, most businesses cannot increase their profits. Hence, budget management is crucial to business success, but most businesses have yet to learn (Uwonda, 2013).

Moreover, the result of the study carried out by Oyelakin and Abdullahi, (2022). reveals that the financial management of SMEs is significantly and favorably affected by staff training, the control environment, information and communication, and risk assessment. While monitoring efforts have a negative and considerable impact on SMEs' financial management, control activities have a positive and negligible impact. Furthermore, SMEs operating in different industries do not significantly differ from each other in terms of their performance in financial management practices, still there is a substantial and positive association between that and the education level of small business owners and managers. However, there is a significant difference between small- and medium-sized businesses that are five years old or older and those that are younger.

## **2.2 Theoretical Background**

Successful businesses, especially SMEs, usually go through a life cycle of development (Leach & Melicher, 2009). The venture life cycle starts in the development stage, progresses through several growth stages, and "ends" in the mature stage. According to the life cycle theory, there are five stages in the life cycle: development, startup, survival, rapid growth, and early maturity. The life cycle model for venture operations and financial decisions was established by Leach and Melicher (2009). They claim that the entrepreneur is preoccupied

with selecting the basic organizational structure, creating the initial financial statements, and figuring out how to get startup finance during the startup stage. According to them, the entrepreneur must forecast the venture's cash requirements, monitor financial performance, and get first-round financing during the survival stage. Typically, at this point, the business is spending more money than it is bringing in from operations. Financial statements develop into a crucial tool for both internal and external communication. The survival of a venture depends on the ability to secure sufficient financial funding. Many small businesses never make the crucial transition to speaking effectively with the financial world; as a result, they are unable to secure the money they need to pursue their entrepreneurial dreams.

Apart from that, based on the separate business entity concept, owner of the business and the business considered separate entities (AccountingTools, 2022). Therefore, transactions performed by the business are separate from those performed by the business. The personal and financial transactions and events of the business owner should not be recorded in the financial reports. This separate business entity concept permits truthful recording of the entity's performance and financial position. SMEs must adopt separate entity accounting concepts for financial reporting and business decision-making (Quinn et al., 2020).

### **3 Methodology**

This study aimed to identify the financial mismanagement of small businesses. As the mismanagements are subjective to the owners' knowledge, it is essential to explore their experience. Despite the prevalence of quantitative studies in this area, they fall short in capturing the actual perspectives of respondents through questionnaires; hence, to dig deeper into the details and discover a richer understanding, researchers have selected the qualitative methodology for this inductive study, which aligns with Creswells (2007) characteristics of qualitative research. The primary aim here is not measurement but exploration, specifically, to uncover the financial mismanagement in small businesses in Sri Lanka. Therefore, a general qualitative approach was used to conduct the study, a mix of all qualitative research philosophies. To collect data, the researchers conducted face-to-face, in-depth interviews for one hour on average. Interviews were conducted with the six small scale hotel owners in the Talawakele - Lidula Municipal Council area in the Nuwara Eliya District. The sample was selected based on the purposive sampling method, and the sample size was based on the saturation point. For the post clarification, the average time of 20 minutes phone conversations were conducted with the respondents. The verbal consent of all respondents

was obtained before the interviews, and the discussions took place in the owner's house or business places. In the first stage of the interview, interviewees asked for a self-narration, and as the second stage, main interview questions were asked. Furthermore, with the consent of five participants out of six, financial records were observed to confirm the statements made by the participants. Apart from this, before entering the field, researchers discussed with the Lidula area's development officer as key informants to understand the interviewees' business background.

The data collected through interviews were analyzed using thematic analysis. Researchers adopted the six-phase thematic analysis approach explained by Braun and Calrk, (2006). In the first phase of data analysis, transcripts were read several times and found and removed repeated text. Then, the researchers identified codes and provided labels for similar text relevant to the research questions. As the third step, codes were converted to the themes by capturing the critical data in relation to the research questions. After that, developed themes were reviewed in relation to the coded data and the entire data set. In the next phase, themes were defined and given names. Finally, the researchers have compiled the themes and produced the article.

Further researchers have ensured the reliability and validity of the study based on the set of strategies of Creswell, (2007). Thus, the researcher maintained proper methods to manage data and kept accurate records of contacts and interviews. Through member checking, we sent transcripts to participants who concurred with the researcher's inferences after reviewing the findings, confirming the confirmability of our results. Following initial data analysis, this iterative process incorporated participant feedback, insights, corrections, and clarifications, ultimately enhancing the result's trustworthiness. Additionally, researchers sought external validation through consultations with seasoned qualitative experts in management. These experts reviewed the research design, data collection methods, and preliminary findings. Their valuable input provided an external perspective on the study's rigor and credibility. Their feedback guided in refining our research approach and ensuring that the qualitative methods adhered to best practices in the field.

#### **4 Findings and discussion**

Through the data analysis, the researchers answered the research question of the study.

#### **4.2 Managing Startup Capital**

Start-up capital is significant for any business and essential to managing it properly (Wu & Song, 2008). It is often impossible to properly use start-up capital due to poor financial management. Businesses often get into trouble for not handling the funds they receive.

According to respondent C,

*“Finding the initial capital is a challenge. But once the funding is available, managing it is even more challenging. Because we initially spent start-up capital without a plan and without a prediction of the future. So, I had to add to my savings to the business. It will not happen if the expenses are planned properly. Failure to properly manage the initial capital will cause serious damage to the future of the business.”*

This statement shows that mismanagement of start-up capital can profoundly affect the success of a business. According to Wu and Song, (2008) study, it is confirmed that most small businesses fail due to poor management of business capital. This shows that the lack of a proper capital plan for the business is a disadvantage. Everyone who has been the subject of this research has made this mistake.

Respondent B confirms this,

*“There was no problem in raising funds. There was no big plan to spend those funds. I spent on the opportunity. Spending like that did not break the business. But maybe it would have lost the business advantage. “*

It is essential to have a plan at all times. According to the business life cycle theory, finding startup finance is a duty of the entrepreneurs at the startup stage, and further, to manage capital effectively, it is necessary to prepare initial financial statements (Leach & Melicher, 2009). It is necessary not only to accumulate capital but also to manage it. With such a plan in place, the business can run smoothly. Thus, this research shows that small businesses in Sri Lanka still need a plan. According to the research, small businesses understand this only after everything has happened. Therefore, the study reveals that the lack of proper capital management has led to the failure of the business. A business cannot run according to a plan without appropriate capital management, nor is it possible to know how to recover that amount of money spent. The statements of the respondents confirm this. Thus those problems do not arise if there is proper capital management. Then it can be implemented according to a good plan.

Another critical point identified by this study is that small business owners ignore interest rates when obtaining capital.



According to the respondent F,

*“I got in touch with People's Bank a lot when regarding loans. Due to my friendship with that bank, I did not pay much attention to interest rates. Maybe I could have borrowed from other banks at a lower interest rate, but I took loans from People's Bank based on friendliness and my bank accounts in People's Bank. Also, I did not expect to get loans from moneylenders.”*

According to the responder, owners get a loan based on their relationships. While this is good for the relationship, it is also bad for the business. Five respondents were of this opinion, and only one had a different view.

Responder A confirms it,

*“When we take a bank loan for a business, we pay little attention to interest rates, because most interest rates are the same in banks. So, we don't think about interest rates. But lowering interest rates by even a tenth is an advantage for the business. But we are looking at the convenience of getting a loan faster than the interest rate. It is often to our disadvantage.”*

According to Bbenkele (2007), small businesses, especially those from rural areas, needed better knowledge of banking services. Further, they had a minimum understanding of the bank loan procedures for their business.

Thus, it is clear from this research that most small businesses focus only on accessibility when obtaining capital. It is a matter of financial literacy. These interest rates often vary slightly and often coincide between banks therefore it is essential to understand this. Therefore, a business is a for-profit factor, it essential to take advantage of even the most minor thing. This research shows that this mistake is at the top of small businesses which creates disadvantage. When raising funds for a business, a feasibility study should be done. Most Sri Lankan small businesses do not conduct feasibility studies to raise capital. Often, ignorance about it can be the factor that shortens of the business's long-term. As mentioned earlier, this reduces the chances of the business gaining an additional advantage. The research results show that small businesses continue to suffer from this disadvantage.

The mismanagement of startup capital in small businesses can be attributed to several interconnected factors, each contributing to the challenges faced in effectively allocating and utilizing financial resources.

### **4.3 Managing Cash Flow**

Correctly identifying cash flow can enhance the business performance. An entrepreneurial venture depends on money, and the business fails if there is insufficient money to run it (Leach & Melicher, 2009). Accordingly, if small businesses run with proper cash flow management, it will be easier to manage emergencies. According to responder D,

*“I do not pay much attention to cash flow. I spend according to the way money comes into my cash business daily. But there are times when it becomes a problem. There have been many instances where the business has run out of money while the creditors prepare to repay their debts. This is my sole proprietorship, so I do not pay much attention to how the cash flows come in.”*

This shows that the above respondent's businesses operate daily without understanding cash flow. They often believe that practically everything about cash flow cannot be focused on. This is the idea of all the small business owners involved in this research. Further, some businesses identify cash flow based on their assumptions. Regarding this, responder A stated that:

*“I get my idea of the money coming into the business based on the stock. I understand that so many transactions have occurred when the stock is declining. Although I do not use any of the specified accepted accounting methods.”*

This shows that different people have differently constructed the concept of cash flow in mind. The other important thing is that none of them has a proper cash flow accounting system. Some people identify cash flow with their minds, while others keep notes in their way, and some have no idea about it.

Regarding this, respondent E gave his thoughts as follows:

*“No idea about cash flow. The business operates on a day-to-day basis. But we have a rough idea of the cash coming in and out of business at the end of the day. we did record those data, and it's a simple note system inherent in us.”*

This explains the weakness of cash flow management in small businesses. Most small businesses need to learn about cash flow management as they lack financial literacy. In SMEs, the implications of cash flow mismanagement can be particularly severe. According to the literature, poor cash flow management is recognized as a contributing factor to lower profitability, growth, and productivity of small businesses (Mungal & Garbharran, 2011).

The present study revealed that if business managers and owners have basic cash management knowledge, that will help for businesses to maintain their cash flow properly.

The study also identified sufficient evidence testifying that a greater portion of business owners is operating a business without keeping financial records in place and without any knowledge of small business management. These findings contradict with the theory used to derive the base of this study, the business life cycle theory, which proposes that the entrepreneur must forecast the venture's cash requirements, monitor financial performance, and get first-round financing during the survival stage (Leach & Melicher, 2009).

However, to mitigate challenges in managing cash flow, SMEs should prioritize financial education and seek professional advice, implement efficient financial and operational processes, closely monitor cash flows, maintain adequate cash reserves, and develop contingency plans to navigate economic and market fluctuations. Proactive cash flow management is crucial for the sustainability and growth of SMEs (Widdowson & Hailwood, 2007).

### **4.3 Budgetary system**

It is vital to predicting the costs and revenues of the business accurately. Accordingly, the financial management of the business should be work by preparing a suitable budget system.

Respondent C commented as follows:

*“Honestly, I do not use a budget process for my business. Because it is impossible to accurately determine the transactions that may occur during the month. Therefore, the business cannot be run in practice according to a budget. But if you have a budget, it's easy to do business ... but with the economic situation in Sri Lanka, wholesale prices change daily ...so it's tough to do business with a budget. If you can do it on a budget, it's worth it for the business, but with the current situation, it's tough.”*

The most important thing that can be identified from this response is that the respondents consider it is essential for the business to have a budget policy which inlines with Leach and Melicher (2009) proposed that the survival of a venture depends on securing sufficient financial funding.

This is further confirmed by Respondent F's statement below.

*“The budget concept is fundamental, but we cannot do it in practice. Even if we do business with such a plan, they can change, however, I also acknowledge that a budget is an important factor in a business and directly affects the business success.”*

Accordingly, business owners as a whole acknowledge the importance of budget policy. They agreed that budget is an essential factor in determining business profit, and they felt that if they had good budget management, they could increase their business profit. However,

their view is that it could not be implemented. This affects various factors, such as the inability to correctly identify cash flows, constant change in stock prices, unpredictable business activities, difficulty in adequately identifying revenue and expenditure, and the country's economic instability (Maduekwe & Kamala, 2016).

The SME owners who participated in the study did not have a gross budget policy. Their discussions also showed that they often fail in budgeting and do not maintain the budget policy in the long run. Therefore, it is wrong to develop such an idea without budgeting and implementing it in the long run. It is essential to have a budget policy to succeed. Therefore, businesses that operate without a good budget policy are unstable. Maduekwe and Kamala (2016) summarized results indicating that approximately 55% of respondents said lack of top management support, lack of qualified personnel, lack of required resources such as computers, and a lack of awareness about the importance of budgets are the factors that inhibit the preparation of budgets.

The economic situation of the country is something that cannot be ignored when considering the budgetary policies of businesses. Commodity price fluctuation, lack of foreign reserves, restrictions on imports, rising inflation, increased supply to the market, and the emergence of the black market can effect budgeting (Chugunov & Markuts, 2019). However, all of these businesses started at least eight years ago. The current economic crisis has erupted with the corona; thus, the country's economy was relatively good before that. Even at that time, they did not have a budget policy. So that argument clashes with each other. Overall, the investigation shows that small businesses are operating without a proper budget policy, which is a massive disadvantage for the business. Accordingly, this analysis indicates that the lack of an appropriate budget policy is a significant financial management error for small businesses. A business needs a proper budget system. Otherwise, the business will not be able to run as planned. It is a feature of a failed business. Accordingly, the efficiency of the business has been reduced due to a lack of proper budgeting.

#### **4.4 Personal spending**

Every business must continuously operate on the concept of a business unit where the purpose is to maximize profits. Therefore, the business must act as a separate entity from the owner (AccountingTools, 2022). In accordance with the separate business entity, the business must operate independently as a single entity in conducting financial transactions (Knittel & Nelson, 2011). This study explores whether the business owners were continuously

discharging their expenses through the institutions. The followings are the views of the respondents about personal spending.

Respondent A:

*“There is no limit to the personal expenses incurred from the business’s resources. In an emergency, we have to buy goods from the business for personal consumption. There is no limit to those expenses. Because of those costs, it is difficult to calculate the exact profit of the business, but we are used to it now.”*

Respondent B:

*“Personal expenses go without limit. Because I run my business as an agent to cover my home expenses, I have identified the personal expenses incurred through the business as my income. Because this is my retirement plan, there is no limit to that.”*

Respondent F:

*“I do not see making personal expenses out of business as a mistake. Because business depends on us, we depend on business. The problem is doing it without limits. We make the same mistake. And they are not reported.”*

The above data show that all the respondents are spending money for their personal requirements from the business without any restriction. The answers given by the respondents as a whole depict that they do not believe it as a harmful business practise. However, few know that making personal expenses from the business cash flow is awful; they knowingly make mistakes. That contradicts the suggestions of separate entity concept as suggested by Quinn, et al. (2020) to separate owner’s spending from the business transactions. This is what respondent E said:

*“As a result, it is difficult for us to calculate the monthly profit or loss. That's a big disadvantage. That is why it is often not possible to have a proper understanding of inventory. It would be our advantage to properly reduce and record those unnecessary personal expenses.”*

This shows that personal expenses incurred without management and reporting can interfere with the correct profit calculation of the business. These comments clearly show that they spend their personal money indiscriminately through the business and do not report it properly.

#### **4.5 Retained Earning Practices**

A business must have a risk management process. Due to the current unpredictable economic situation, facing the risk of the unexpected is necessary. The same is true of a small business. Although large businesses use modern Enterprises Risk Management Systems, small businesses do not currently use such systems due to their nature. Many small businesses in Sri Lanka do not even insure their business. However, having a proper risk management framework for the financial system is essential to the business. Accordingly, the retained earnings business needs to exist to manage future financial risks. From the interviews, it was identifiable that mall business owners do not maintain retained earnings.

Respondent E is mentioned below.

*“If such a risk arises, personal money will have to be invested because we do not maintain such retained earnings. That is our weakness. It should be identified before the risk comes, and it is not advisable to plaster it with emergency procedures after the risk has arrived.”*

It is clear from this statement that small business owners have yet to learn about the importance of having retained earnings. They do not identify risks in advance and take remedial actions. Some small businesses maintain retained earnings properly, though, it has stalled. Respondent C has explained it:

*“That's an excellent question. We maintained a reserve to use for business emergencies because we learned a lesson from not being able to manage startup capital properly. Although we did not have a proper accounting system for the business, we did get some profit from the business. Part of that profit was put into that reserve. But at some point, I had to get that money for something private. After covid 19 pandemic situation, an additional attempt had to be added to reactivate the business. It would be benefited us to maintain those savings without spending.”*

It is evident that there is a lack of proper management and abandonment in long term. The lack of retained earnings exposes the business to future financial risk. They are ready to manage their risks through external means. However, it is know future risk management while adequately maintaining the earnings retained in the business. Business owners think of profit at that moment more than in the future. Without such a proper cost management system, the profitability of the business will not be adequately calculated which is a feature of a failed business. According to Leach & Melicher (2009) many small businesses never make the crucial transition to speaking effectively with the financial world; therefore, they are unable to secure the money they need to pursue their entrepreneurial dreams.

#### **4.6 Managing working capital**

Sunday, (2011) revealed that working capital is vital for small business success. If the working capital is not managed correctly, the business will be imbalanced. Therefore, it is crucial to maintain balanced current assets and current liabilities ratio. It is the backdrop to a successful business. The business may face unexpected financial risks if those rates are not maintained properly. However, small businesses fail quick after starting due to poor financial management, especially working capital management (Fernando, 2011). Most small businesses do not care about their working capital position. Most have little regard for their position, and most do not even have a standard credit policy. Mismanaging working capital in a business often occurs due to inefficient cash flow management, excessive inventory, slow accounts receivable turnover, or inadequate accounts payable management (Uremadu et al.,2012)

When asked about the creditors, the respondents came up with the same idea. This is F's idea of that.

*“We make timely payments to creditors because their support is valuable to us. Even when there is no cash on hand, the payments are made on time with the help of the bank. Credit details are not entered, and formal accounts are not maintained. I use a note on those loan payments as per my convenience.”*

He believes that the business payments to the creditors are somehow being paid correctly. This is the opinion of all the small businesses that have been subjected to this study. However, small businesses do not use standardized accounting systems to record that. They record them in their way, informally. Respondent B explained their strategy for debtors as follows:

*“My business does not have a proper plan for dealing with debtors. Because when people who know me ask for goods on credit, they have to lend goods. Then they fail to give the credit value to the business. So, there is no guarantee that the business will properly get the revenue it deserves. Also, keeping records of debtors is not done systematically in my business. We cannot even ask the debtors for refunds because we cannot agree the customers. Therefore, bad situations often arise in the business.”*

Clearly that business owners were trying too hard to protect their debtors. It put them at a disadvantage. Furthermore, small businesses do not keep records of debtors following accounting policies, and some businesses have only a mere memory of small borrowers. It

does not fit the business at all as the primary purpose of a business is to maximize profits, it is crucial to report small or cheap sources. On the whole, however, small businesses have come to a loss to protect their debtors.

Similarly, not all the businesses subjected to this study had a stock control system. The study also found that every small business purchases based on closer relationships to wholesale prices. That is, to avoid making the friend angry. It's the wrong thing to do on the business side. This is clear from B's statement below.

*“When buying goods in bulk, I do not pay much attention to the price. Because the customers want to supply the goods adequately, we buy the stocks according to the occasion. When I purchase goods for my business, I buy stocks from ex-sellers who have been with me. If other sellers' stock prices are lower, I will not buy that. Because my old seller's relationship with me was important, I did not make a formal note of the stock. Write in the books based on their size rather than the wholesale price. Because the stock quantity is important to me, I can know about it when the stock runs out. “*

Overall, this test shows that small businesses do not have a better concept of working capital. Poor working capital management is a mistake made by small businesses, and they may face business problems due to not maintaining proper account books.

## **5 Conclusion**

This study examines the financial mismanagement of small businesses. The study functioned as qualitative research, gathering data from interviews and observations. The thematic analysis was used in data analysis and identified six main mismanagements of small businesses. Those are the poor management of startup capital, poor cash flow management, lack of proper budget policy, failure to maintain retained earnings for future risk management, lack of understanding of working capital, infinite personal spending through businesses, and poor financial reporting. As a result of these financial mismanagements, the business has to deviate from its' original purpose of profit maximization. The business has lost the opportunity to work according to a proper plan and cannot correctly calculate the business's earnings. Further, the procurement process of the business has stalled. Money in the safe is uncertain due to insufficient financial discipline (Lewis, 2015). All of this hinders the success of the business.



Though many types of research have been done on financial mismanagement worldwide, a lack of studies was conducted in the Sri Lankan context. Further, many types of research are based on a single financial mismanagement. In contrast, a lack of research studies explored several financial mismanagements jointly in a single study (Rötheli, 2010), and most of the previous studies are based on the corporates, not on small businesses. In implementing this research, the quantitative methodology was adopted, and it contributes to the literature from the methodology perspective, where the majority of studies relevant to financial management are conducted as quantitative studies. Accordingly, the results obtained from this research can give a comprehensive idea of the financial mismanagements made by small businesses in Sri Lanka, and these results will help to avoid those issues while achieving success in the future.

Therefore, policymakers can use these results to formulate practical policies regarding small businesses. In particular, this study revealed that the financial literacy of small businesses is very low. Further, these results provide insight into the areas in which literacy should be enhanced. Previous research rarely offered an idea of risk management through retained earnings. This study identified the lack of retained earnings as a risk for the business in the future. Thus, the findings about small business practices can significantly contribute to the financial management practices of small businesses in Sri Lanka. By referring to the present study, small business owners will be able to identify the strategies to minimize the mismanagements identified in this study. Further, it is suggested that training be provided for employees to prepare financial statements and manage finances according to financial principles (Oyelakin & Abdullahi, 2022). It is also identified that the government's role is to support small businesses' survival and growth. This study will help the relevant government authorities understand the financial mismanagement affecting the failure of small businesses and educate owners of small businesses on how to avoid those mismanagements for survival. In relation to the study's findings, small business owners need to prepare proper financial statements in line with accounting principles. They can retain the earnings without using the entire profit. Therefore, these retained earnings funds can be used to fulfil future financial requirements. Moreover, this study emphasizes the importance of making and working on a budget. Moreover, they need to create a standard credit policy to manage working capital effectively. Other than those, they can identify their regular expenses, use digital finance tools, proactively monitor their finance, and have a debt management strategy.

Though the study contributes to the practicality and literature, it also has some limitations, similar to all the other studies. The sample selected for this study was the Talawakele-Lidula Municipal Council area. It is a small sample, which may constrain the study's findings. To improve the findings, future researchers can consider extensive geographical areas. Researchers have interviewed only small business owners, and it is suggested that future researchers use data triangulation by interviewing small business owners, employees, and owners' family members. This study covered small businesses in the hotel industry. If future researchers can research different industries, they will give different findings.

Moreover, being a qualitative research study, the findings of the present study cannot be generalized. However, this study aimed not to generalize the findings but to dig deeper into the context of small businesses' financial management. To generalize the findings, future researchers can conduct quantitative studies by applying the results of the present study.

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