

## **The Effect of Financial Accounting Practices on the Performance of MSMEs**

**Lucia M. Ferraro**

Faculty of Digital Systems, Bellavista University, Italy

**Received: 09/01/2026; Accepted:02/03/2026; Published: 10/08/2026**

### **Abstract**

Micro, Small and Medium Enterprises (MSMEs) make an important contribution to employment, income generation, innovation, and local economic development. Despite their importance, many MSMEs face difficulties in maintaining systematic financial records and using accounting information for managerial purposes. This paper examines the effect of financial accounting practices on MSME performance, focusing on record keeping, financial reporting, budgeting, cash-flow management, and the use of accounting information in decision-making. Effective accounting practices can improve the availability and reliability of financial information, support better resource allocation, strengthen financial control, and assist owners in evaluating business performance. They may also improve access to external finance by providing lenders and other stakeholders with clearer information about the financial position of the enterprise. However, the adoption of sound accounting practices can be constrained by limited financial literacy, lack of trained personnel, cost considerations, and informal management practices. The paper concludes that systematic financial accounting practices can contribute positively to MSME performance when supported by appropriate accounting knowledge, affordable technology, and effective managerial commitment.

### **Keywords**

Financial Accounting; MSMEs; Financial Performance; Accounting Practices; Record Keeping; Financial Management; Small Business

### **Introduction**

Micro, Small and Medium Enterprises are important contributors to economic activity in both developing and developed economies. They create employment opportunities, support entrepreneurship, contribute to household incomes, and provide goods and services to local and wider markets. However, MSMEs frequently operate with limited financial and human resources and may rely heavily on owner-managers for accounting, financial, and operational decisions.

Financial accounting practices provide the information required to understand the financial position and performance of a business. Basic practices such as maintaining

records of sales and purchases, preparing financial statements, monitoring cash flows, controlling expenses, and reconciling accounts can help owners understand whether the enterprise is generating sustainable returns. When such practices are weak, business owners may make decisions without reliable information about costs, profitability, liquidity, or outstanding obligations.

Previous research has examined the relationship between accounting practices and the performance of small and medium-sized enterprises. Studies have generally highlighted the importance of accounting information, financial record keeping, accounting skills, and management accounting practices in supporting business performance. The usefulness of accounting information can be particularly important for owner-managed enterprises because owners often make strategic and operational decisions directly.

The purpose of this paper is to examine the effect of financial accounting practices on MSME performance. The discussion focuses on five areas: financial record keeping, financial reporting, budgeting and planning, cash-flow management, and the role of accounting information in managerial decision-making and overall performance.

### **1. Financial Record Keeping and MSME Performance**

Accurate financial record keeping is the foundation of effective financial accounting. MSMEs need systematic records of sales, purchases, expenses, assets, liabilities, receivables, and payables. Such records allow owners to determine how much money is entering and leaving the business and provide evidence for evaluating financial performance.

Poor record keeping can make it difficult to distinguish business funds from personal funds, calculate actual profit, identify unnecessary expenditure, or monitor outstanding customer balances. In contrast, systematic records provide a historical basis for analysing trends and preparing financial statements. Research on small businesses has emphasized that the availability and use of accounting information can support better management and performance.

### **2. Financial Reporting and Business Performance**

Financial reports provide a structured summary of business activities and financial position. For MSMEs, basic reports such as income statements, balance sheets, and cash-flow statements can help owners assess profitability, liquidity, asset utilization, and financial obligations. Regular reporting can also make it easier to compare current performance with previous periods.

Reliable financial reports can support external relationships as well. Banks, investors, suppliers, and other stakeholders may require financial information before providing credit or entering into business arrangements. Sound accounting practices can therefore improve the credibility of the enterprise and potentially strengthen its ability to obtain external resources.

### **3. Budgeting, Planning, and Cost Control**

Budgeting is an important accounting practice for controlling financial resources and planning future activities. An MSME can prepare budgets for sales, operating expenses, purchases, wages, and capital expenditure. Comparing actual results with budgeted figures allows managers to identify significant variances and investigate their causes.

Budgetary information can also improve cost control. When owners understand the major components of operating costs, they can evaluate whether expenditure is necessary and identify areas where resources can be used more efficiently. This can contribute to improved profitability and financial sustainability, particularly in enterprises operating with narrow profit margins.

### **4. Cash-Flow Management and Financial Stability**

Cash flow is critical to MSME survival because a profitable enterprise can still experience financial difficulties when cash is unavailable to meet immediate obligations. Accounting practices that monitor cash receipts, payments, receivables, payables, and short-term commitments can help owners anticipate periods of cash shortage.

Effective cash-flow management enables MSMEs to plan payments, manage working capital, negotiate with suppliers, and determine when additional financing may be required. It can also reduce the risk of delayed payments and unnecessary borrowing. Accounting information therefore contributes not only to measuring performance but also to maintaining day-to-day financial stability.

### **5. Accounting Information, Decision-Making, and Overall Performance**

The value of accounting practices ultimately depends on how financial information is used. MSME owners can use accounting information to evaluate product profitability, determine prices, assess investment opportunities, control costs, manage inventory, and decide whether to expand or modify business activities. The use of timely and relevant information can reduce uncertainty and improve the quality of managerial decisions.

Research on SMEs has identified accounting information and accounting practices as important elements of financial management and business performance. However, the benefits of accounting depend on the skills of business owners and employees, the quality of records, and the willingness of managers to use financial information in decision-making. Digital accounting tools can make record keeping easier, but technology should be supported by appropriate accounting knowledge and internal controls.

### **Conclusion**

Financial accounting practices can have a meaningful effect on the performance and sustainability of MSMEs. Systematic record keeping, accurate financial reporting, budgeting, cash-flow monitoring, and effective use of accounting information provide owners with a stronger basis for controlling resources and making business decisions.

The discussion indicates that accounting practices can support profitability, liquidity management, financial control, and access to external finance. However, MSMEs may face barriers such as limited accounting knowledge, shortage of skilled personnel, cost constraints, and informal management practices. These barriers can reduce the extent to which accounting information contributes to business performance.

MSME owners should therefore be encouraged to adopt simple but systematic accounting procedures and use affordable digital accounting solutions where appropriate. Training in basic financial literacy and accounting skills can further improve the quality and usefulness of financial information. Future empirical research can examine these relationships across different industries, geographical regions, and categories of MSMEs to identify the accounting practices that have the strongest effect on business performance.

### **References**

- Abor, J., & Quartey, P. (2010). Issues in SME development in Ghana and South Africa. *International Research Journal of Finance and Economics*, 39, 218–228.
- Al-Dalabih, F. A. N. (2018). The impact of the use of accounting information systems to improve the efficiency of internal control in Jordanian commercial banks. *International Journal of Economics and Finance*, 10(4), 99–108.
- McMahon, R. G. P. (2001). Business growth and performance and the financial reporting practices of Australian manufacturing SMEs. *Journal of Small Business Management*, 39(2), 152–164.
- Maseko, N., & Manyani, O. (2011). Accounting practices of SMEs in Zimbabwe: An investigative study of record keeping for performance measurement. *Journal of Accounting and Taxation*, 3(8), 171–181.
- McChlery, S., & Godfrey, A. D. (2004). The use of accounting information by small and medium-sized enterprises in Scotland. *Journal of Small Business and Enterprise Development*, 11(1), 114–120.
- Prempeh, K. B. (2015). The impact of efficient inventory management on profitability: Evidence from selected manufacturing firms in Ghana. *Research Journal of Finance and Accounting*, 6(24), 83–90.
- Winborg, J., & Landström, H. (2001). Financial bootstrapping in small businesses: Examining small business managers' resource acquisition behaviors. *Journal of Business Venturing*, 16(3), 235–254.