

Effect of Accounting Practices on Financial Performance of Small Medium Enterprises in Rwanda

A case study of Musanze District

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Abstract: The overall objective of this study is to investigate how poor record keeping can cause the negative failure of SMEs in Musanze District of Rwanda; to evaluate the extent to which low level of budgeting techniques can lead to poor ability of SMEs expansion in the particular area. The study adopted a case study research design to enhance an in depth investigation of the targeted population of the SMEs residents in Musanze District, Northern province, Rwanda. 60 respondents were arrived at using proportionate stratified. The study gathered primary data through open and closed end questionnaires. Over 70 Questionnaires were distributed to 60 SMEs owners out of which 60 questionnaires were valid and analyzed using Likert scale. To point out on how record keeping can be very vital to SMEs, it is good because it helps SMEs to achieve her goals and objectives and on other hand a lot of SMEs owners in Musanze lack accounting skills, they keep their record manually thus no accounting system they were using. The researcher recommended that SMEs owners in Musanze District should try to buy latest software for keeping records in their firms and hence equipping themselves with essential managerial skills which are necessary for the expansion of SMEs.

Keywords: Financial reporting, Recordkeeping, Budgeting, SMEs performance

I. Introduction

Across the globe, SMEs are the lead drivers of job creation and economic development. Smes are very important as whole because of objectives in the Rwandan Economy in general, they create new jobs opportunities and therefore most of the firm can be enable to expand to the big ones , business are catalysts for which they have dominated the industrial sector, both smes have significance role in many developing countries. Developed and underdeveloped countries. Even though, some of them have adequate capital, many of them fail due to poor financial management operations. Many scholars have carried out a lot of research about this topic on smes. Smes was generally one which employees lower than 200 people thus having three additional characteristics, owners worked and took a personal interest in business, not part of another (large) enterprise two years. Tushabomwe (2006) the inefficient skills, recording problem and many other factors results into the down fall of a lot smes.

According to Mc Cannon (2002) he said that little firms in Africa continent collapse because as results of managerial skills problem, inadequate proper recording and poor financial reporting, given that the important of these, one would therefore wonder why operators are not in position of maintaining books of account in the particular area.

According to stokes and Wilson (2006), Small Business is different in several respects to management in larger organizations, because of social structures and relationships, and because of the levels of resources available. While these differences may drive from the size turnover, it is their management implication that will be their concern. E.g, manager who has specialist departments turn to for a device, who takes messages from creditors seeking payments due to cash shortage and who has to choose between keeping an appointment with a customer, is facing situations typical of the control of small rather than large business.

1.1 Problem statement

Accounting practices are very essential in the direct and control of smes because accounting practices help firms owners to have accurate information where they owners can relies on them when making smes decision making such as in the projection of the sales and purchases and making a big numbers of other financial analyses, but even with this in Musanze District, Northern Province, did not given much attention to them. Not only that, continued limited records keeping and poor financial reporting, have been initially seen as factors that results into the down fall of these smes (Tushabomwe, 2006). The particular smes that very bad record keeping, resources mismanagement, high tax rates hence resulted into down fall of many firms. Not only that Some Studies are showing that it is very hard for smes owners to access loans from banks and many sacco's due to poor financial records as a requirement in financial institutions of particular area and at given period of time. Previous studies conducted by other scholars do not show the ways to overcome the problem of poor records keeping, problem of high tax rates, inadequate capital, lack of technical and managerial etc which are needed at smes institutions for survival.

To fill the gap, the study show the strategies for improving skills in term of poor technical and managerial skills in the particular area, not only that inadequate of capital should be addressed through the government project by giving ,grants, loans to grow their own businesses. Many more issue of lack of technical and managerial skills, government should equip the entrepreneurs with technical skills to achieve their goals and objective in the particular area and lastly government should lower the tax rates against smes in the particular area such to operate effectively and efficiently in the particular area.

1.2 Objectives

- i.** To establish the effect of record keeping on financial performance of small medium enterprises in Rwanda.
- ii.** To examine the effect of Budgeting on financial performance of small medium enterprises in Rwanda.
- iii.** To investigate the effect of financial reporting on financial performance of small medium enterprises in Rwanda.
- iv.** To examine the effect of internal control on financial performance of small medium enterprises in Rwanda.
- v.** To determine the role of government policies on the performance of small medium enterprises in Rwanda.

II. Literature Review

2.1 Concept of Performance

Performance means success, competitiveness, achievement, action, constant effort, it is optimizing the present and protecting the future. Performance is created by a company through environmental reporting, following the way of creating value. According to Alazard and Separi (1998), performance leads to a global vision of interdependencies between internal and external parameters, quantitative and qualitative, technical and human, physical and financial ones of management. More so, it is also initially attracted by its market position. Profitability its main components; net turnover and net profit margin. Both components are parameters of profitability. In concurrence, some scholars have used, profitability, better facilities and meeting required standards as proxies for business performance (Frolick&Ariyachandra, 2006; Macey,2001).

2.2 Concept of accounting practices

This is an important assumption of accounting as it gives the very basis for showing worth of assets in the balance sheet in the particular organization. According to European Commission (European Commission, 2008) affirms that utilization of accounting practices for a successful management of any entity, whether large or small especially in detecting fraud and theft in the firm. This is why these accounting practices are capturing the picture of most SMEs owners. This is accompanied with proper documentation of the firm's transactions of financial reports and records (Aruwa, 2005).Not only that, smes owners observed that they prefer to look into on making and selling their products and services rather than keeping accounting books. This perception is attributed to smesoperators believed that accounting practices are too bureaucratic and time consuming (Mairura,2011).

2.3 Theoretical literature review

The various theories on these practices for a country include but not limited to; the record continuum theory, classical growth theory and Agency theory. The theories are briefly expounded below as follows;

2.3.1 The record continuum theory

This theory gives the theoretical details for keeping business records, according to the Australia Standard, observed that that 4390 clearly indicated that the records continuum theory is initially the excellent consistent and coherent of the management processes in the particular area with the view to improving efficiency as well satisfying users in the particular area. Flynn (2001) found that the theory is very vital thus records continuum theory assist in giving very clear perspective of understandability and interpretation of practices given by production cycle.

According to Peacock (1988) he found that the inefficient, poor accounting techniques results into the down fall of many firm. Given the important of keeping great record in the firm, one would therefore wonder why some firm didn't make it. Record continuum theory is important given the adequate and reliable records of firm activities are contentious issues, therefore provide insights into how recordkeeping can enhance ability to gain profit.

2.3.2 Classical growth theory

This theory was advanced by political economist, Smith, Adam (1776) heighted the well-defined four general canons of taxation. Firstly, the principle of equity thus the subjects of every nation should contribute towards government support in proportion of their protection they enjoy from the state. Secondly, the principle of certainty which advocates that each individual is bound to a certain tax with clear timelines, payment manner and the quantity to be paid. Thirdly, the principle of convenient in that every tax levied at the given time and manner should be convenient to the tax payer. Lastly, economic principle in that very tax that the tax payer is left with some money once the tax is paid to the state.

Number of classical theories include the Ability to Pay Theory and Benefits Received Theory. In line to latter theory, taxes are imposed on the ability of tax payer to remit the payment. The ability to pay principle means that equal sacrifice for all the subjects of the state who are tax payers are involved. This involves the one with heavy shoulders being taxed more heavily and also losing a greater absolute amount of utility. Most progressive tax system leading to complete egalitarian distribution of after tax income. Variables such as assets, incomes and expenditure levels are considered as the best indicators of ability to pay. With regard to benefits received theory, the state should to levy taxes on tax payers according to the benefits they receive from it. That is, the more the benefits a taxpayer receives from the activities, the more the person should pay taxes.

2.3.3 Agency theory

The agency theory is relevant to this study since its governance approach focuses on professionalizing family businesses to be run by professionals aside from the owners. The financial model constitutes the principal foundation for debates regarding the remunerations of managers and directors, the measure of performance assured by the financial market, freedom of expression and the protection of small investors. This predominant model, inspired directly by the Anglo-Saxon large public corporation, has however greatly evolved, the concentration of equity capital in the non-Anglo-Saxon countries and by the considerable spoliation of small investors by the dominating shareholders. Originally dealing with the manager, the attention was moved to the dominating shareholders who would be beneficial of their position to appropriate the major part of the tenant being. In a sense, the financial model is concerned today with the dominating conflict between dominating shareholders/small investors rather than the conflicts between managers/shareholders (La Porta, 2010). Indeed it is clear that the agency theory is relevant to this study since it lays out how the smes should interact and safeguard their partnership.

2.4 The empirical review

The empirical review is all about the studies conducted by other scholars on the same study. According to the research studied by Maseko and Manyani (2011) in Zimbabwe on one hundred (100) SMEs, they pointed out that SMEs are not in position of putting record well in the organization as result of inadequate skills of technological problem in the particular area.

Study worked out by Musah & Ibrahim (2014) they figured out that smes operators indeed have strong ability of keeping information on their heads manually and do not necessarily see to why keeping books of accounts a long side with them.

Research studied by Hussy and Hussey (1994), they have found out that smes lack powerful capacity to pursue their goals and objectives, limited purchasing power that they have and on top smes cannot afford to open in the large scale in the particular area. Large enterprise's mostly emphasis on maximization of wealth of shareholders while smes possess quite many of objectives mainly autonomy, survival.

2.5 Conceptual framework

The conceptual framework describes the relationship between the dependent variable and independent variable. The dependent variable for this research is the performance of Small Medium enterprises while independent variable is Accounting practices.

Independent Variable

Accounting Practices

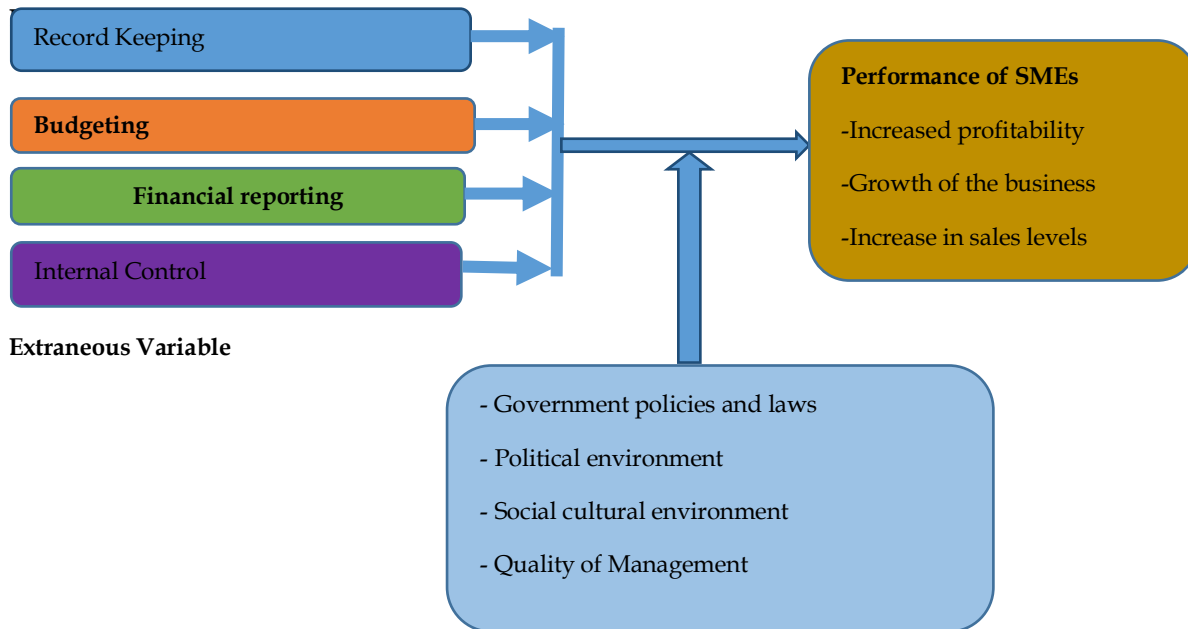


Figure 1: Conceptual frame work

Source: (Author 2021)

III. Methodology

3.1 Research design

The study adopted an explanatory research design. The research design was used to obtain information on the current status of phenomenon. It entails survey and fact-finding and seeks to establish the relationship between the variables. According to Saunders *et al.*, (2007), an explanatory research design is conducted when enough is not known about a phenomenon and a problem that has not been clearly defined. Hence the design was appropriate to the study because the research is a cause-effect relationship. Explanatory research focuses on why questions and it also establishes causal relationships.

3.2 Target population

Study population is defined as all the members of the a real or hypothetical set of people, events or objects to which the researcher wishes to generalize the results of the research study, According to Grinnell and Williams (1990), he defined population as the total of persons or objects with which a study is concerned. In the study, the target populations of the study were:

Hotels, saloons, Vegetable Businesses, Carpenter Businesses, Barber Shops, Charcoal Businesses, Dressing Businesses, Wares and Hard wares Shops ,60 was drawn randomly as number of the targeted populations in the area. Stratified random sample of 40 respondents that is to say 20% of the total target populations was drawn and considered for the study. This sampling method is preferred because it helped the researcher group population's subjects with similar characteristics on the same strata for the purpose of obtaining a common research data Mugenda&Mugenda, (2003).

Table 1: Distribution of target population

Category of residence	Targeted population
Hotels	12
Saloons	9
Vegetable Businesses	11
Carpenter Businesses	4
Barber Shops	8
Charcoal Businesses	5
Dressing Businesses	6
Wares and Hard wares Shops	5
Total	60

Source (author, 2021)

3.3Sample design

This section gives a description of the sample size and the techniques used to sample. It outlines how the method that the researcher used to determine the sample size including the way the sample was drawn

3.4Data collection procedures and instruments

The researcher used structured questionnaires and face to face interviews especially where the respondents were not having time to complete the structured questionnaires. The questionnaires were hand delivered with a self-explanatory letter. To avoid delays the researcher arranged appointment with the target respondents in advance so as to find them at the designated places, mainly their offices. The researcher assured the respondents of confidentiality of the information gathered and ensured the respondents filled in all the questionnaires at their own convenient time.

3.5Data collection methods and tools

The researcher used structured questionnaires and physical interviews initially where respondents were not available due to time constraints. Convenient time was highly considered and this ensured accuracy and reliability of information gathered. The researcher avoided misleading questions and prefer the use of clear questions to avoid biased results.

The following are the main tools the researcher used in collecting data for the study;

3.5.1 Questionnaire

According to Hernon and Whitman (2001) state that, "a questionnaire is a tool designed to ask the same set of questions to several people.

The main tools were the questionnaires, therefore, the researcher prepare questionnaires prior to distribution; a pre-testing exercise was undertaken. The questions were both open ended and close ended which sought to answer the research questions and find out any other necessary information for the study.

3.5.2 Primary and Secondary data techniques

The researcher was using both of the above method to gather data, the researchers prepared questionnaires to collect data from respondents.

The researcher utilizes secondary data obtained from other journals, books written by learned scholars which are similar to this research

3.5.3 Interview

The researcher conducts personal interviews. The vital of this was to obtain extra explanations from respondents that is not there in the questionnaires. Therefore, the structured interviews are useful instrument in the data collection because they allow one to seek for further clarification of the answer given by the interviewees.

3.4 Reliability and validity of the research instruments

Cronbach's alpha coefficient is to test the reliability and validity of data collected. Lee Cronbach (1951) defines reliability as an attribute of an instrument to measure consistency. Consistency shows that an instrument has constructive value. Reliability refers to the extent to which a measuring instrument contains variable errors that appear inconsistent from observation during any one measurement attempt or that vary each time a given unit is measured by the same instrument. Construct validity is established by relating measuring instruments to a general theoretical framework in order to determine whether the instrument is tied to the concepts and theoretical assumptions they are employing (Nachmias & Nachmias, 2008). A pilot study was carried out to determine reliability of the instrument used in the collection of data. This was to ensure that the instrument collected are reliable and valid data.

Reliability analysis was subsequently done using Cronbach's Alpha which measures the internal consistency by establishing if certain item within a scale measures the same construct. Therefore when Cronbach's alpha lies within the $0.8 \leq \alpha \leq 0.9$ then category indicate that the survey instrument was good in terms of internal consistency. Validity is concerned with meaningfulness of research component. The validity of the research was assured through designing appropriate questions for the questionnaire.

Table 2 showed the results of data reliability using the Cronbach alpha coefficient lies within the $0.8 \leq \alpha \leq 0.9$ this category indicated that the survey instrument was good in terms of internal consistency. The results indicated that all the Cronbach alpha coefficients alpha coefficient which shows that the scales are acceptable so that further analysis can be possible.

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Table 2: Reliability

Reliability	Cronbach's Alpha	N of Items
Record keeping	.900	10
Budgeting	.800	10
Financial Reporting	.800	10
Internal control	.900	10
Increased profitability	.800	10
Growth of the business	.900	10
Increase in sales levels	.800	10

IV. Findings

4.1 Discussion of the findings in relation to record keeping on the performance of smes

According to Reed, (2010), he has observed that it gives excellent evidence of how the transactions were managed in the firm and coming up with the great steps of complying with business high quality of operation.

58% rated on point scale one that the business keeps records of credit sales, 42% rated on point scale one that the business keeps records of employees. Also, 43% rated on point scale one that the business records credit purchases. Furthermore, 35% rated on point scale one that the business keeps record of all the receipts and payments.

Moreso, 33% rated on point scale one that the business records all the assets, moreover, 53% rated on point scale one that the business records all its expenditures. In addition, 70% rated on point scale one the business maintain records.

Many more, 58% rated on point scale one that to track materials and ensure that borrowed files are returned worked well. Not only that 75% rated on point scale one that the business keeps record for future analysis.

Lastly, 57% rated on point scale one that it helps in tracking the sale statement.

The objective one was established and hence extent to which the deployment of record keeping practices influence the performance of smes. The finding show that many statements were strongly agree by the respondents i.e, the business

keeps records of credit sales, the business keeps records of employees, the business records credit purchases, the business keeps record of all the receipts and payments of the business, the business records all the assets related to the business, the business records all its expenditures, the business maintain records, the recordkeeping they used to track materials and ensure that borrowed files are returned worked well, the business keeps record for future analysis, record keeping help in tracking the sale statement ,all are very vital when it comes to decision making to small medium owners in the particular area thus strongly relevant to smes.

In relation to the above objective, this implied that SMEs in the study context are maintaining accounting records of their business transactions but still there is minimum number of the SMEs owners who don't keep records as expected in the general practice in accounting.

These results are also in concurrence with the results found by Abdul and Onaolapo (2014) who also found out that the morale of SMEs to keep accounting records is low. They argued that, smes assume that since their business are small with few transactions; keeping records would not do much to the business. Despite this attitude by the SMEs, in Rwanda case it indicated that a lot of them at least maintain one type of accounting records e.g.; record only cash sales, purchases and expenditures.

4.2Correlation Analysis

Table 3showed the relationships between the variables based on Pearson coefficient statistic. The results showed that there was strong positive correlation between record keeping and financial reporting and hence having a positive correlation coefficient of 0.382 and $p < 0.01$. This indicated that record keeping is associated with preparations of financial reports bySMEs. The results also shown that accounting practices of record keeping and financial reporting are significantly related to performance of smes with a correlation coefficient of 0.206 ($P < 0.05$) and 0.382 ($p < 0.01$) respectively. This indicates that effective utilization of record keeping and financial reporting are both significant in association with performance of smes. Additionally, the result of the analysis also showed a positive correlation between the utilization of accounting practices and age of the firm and manufacturing sector.

Table 3: Correlation analysis

	1	2	3	4	5	6	7	8
Record keeping(1)	1							
Financial reporting(2)	.382 **	1						
Performance(3)	.206 *	.382 **	1					
Age of the firm(4)	.026	.140	.098	1				
Retail shop (5)	-.015	.027	-.119	-.083	1			
Agriculture(6)	-.131	-.083	.067	-.156	-.365 **	1		
Manufacturing(7)	.128	.086	.098	.197	-.501 **	-.367 **	1	
Number of employees(8)	.092	.106	.157	.260*	-.238*	.478**	-.271*	1

Levels of significance *** $p < 0.00$, ** $p < 0.01$, * $p < 0.05$ and N = 92

Source: (FieldData, 2021)

4.3 Regression analysis of the link between utilization of accounting practices and performance of smes

The regression analysis was utilized in order to evaluate the level to which the deployment of record keeping and financial reporting can influence the performance. Analysis Ordinary Least Square Method (OLS) of estimation was used and all the variables: control and crucial variables were put in the model at the same time. But for the regression analysis to give valid results some key assumptions have to be satisfied. In this analysis, Variance Inflation Factor (VIF) was used to make sure that the assumption of reasonable differences of the independent variables were satisfied. These were all below the threshold of 10 as shown in table 3: below.

It is indeed very essential that the variables to be included in the model have reasonable correlation for OLS to be meaningful. The respective correlations are given in Table 3 above.

In the correlation matrix there was reasonable and significant correlations reported. The results of the regression analysis are presented in Table 4:below.

Table 4: Results of regression analysis

Variables	Model		
	B	T	VIF
Control variables			
Age of the firm	.067	.435	1.08
Retail shop	-.094	-.282	2.734
Agriculture	.285	.832	2.178
Manufacturing	.148	.448	2.709
Number of employees	.106	1.048	1.473
Independent Variables			
Record keeping	.074	.820	1.314
Financial reporting	.326	4.500***	1.36
R²	.8423		
Adjusted R²	.8412		
F value	2.906**		

N=92, *P<0.05, **P<0.01, ***P<0.001, dependent variable: SME performance

In the model above, the differential contribution of the record keeping and financial reporting to SMEs performance is presented. The overall model comprising these variables and control variables on firm level performance is significant (F= 2.906 P<0.01). Based on the coefficients of this model, the relationship between utilization of record keeping in the study contexts is not Supported (B=0.074, P>0.05). More so, findings strongly shows the evidence for the positive and significant relationship between financial reporting as one of the accounting practices and performance of SMEs (B=0.326, P<0.001). Apparently, the coefficients in the study reveal that for a 10% increment in the effort towards deployment of financial reporting, the SME in the sample would have realize an increment in performance of 3.2%, other factors held constant or remain constant or Vice versa or ceteris Paribas.

From the study above results implies that the model accounts significantly more variance as indicated in the factor loadings than would be expected by chance. Therefore, the study has established variables of financial reporting as factors that influence performance of SMEs in the study context. Significantly, the study results further reveal that the regression model was also very crucial and hence fit for the study so well.

Therefore coefficient of (R²) is84.2%, the relationship is significant. Given the adjusted R²significant 84.1%, initially it show that this model was able to evaluate that records keeping increase the chances of smes survival to achieve her goals and objectives of smes to 84%.

V. Conclusion

The key players in Musanze District are smes and hence smes operators owns term distinct products. The research objective was to study different accounting practices utilized in Musanze District, Northern Province and their outcomes of past on research context of Musanze City. The researcher investigated the utilization practices in Hotels, saloons, Vegetable Businesses, Carpenter Businesses, Barber Shops, Charcoal Businesses, Dressing Businesses, Wares and Hard wares Shops.

The research used quantitative research approach to reach the four study objectives namely; to point out accounting

practices that are mostly utilized; to observe the motivation for and against utilization of the different accounting practices among the SMEs and lastly, to evaluate implications of the different accounting practices utilized. The research used purposive sampling method of interest, specifically, the focus was on owners thus 60 smes participated. The research used correlation analysis and regression analysis to address objectives one and three. Motivation for and against the utilization of practices was addressed using mean and standard deviation.

The first objective examined the extent smes utilized the different accounting practices to influence their performance and hence three competitors. The result showed that a lot of smes utilized these accounting practices to influence their performance. This was also further supported by significant positive correlation that exists between those parameter of the smes in Musanze District. Additionally, smes are so conservative with their local methods of accounting which makes them perceive accounting to be too bureaucratic and time consuming.

5.1 Recommendations of the study

The following recommendations were made on the utilization of accounting practices;

The researcher found the problem of lack of finance to buy software, problem of loan, problem of taxes, poor business skills, the researcher recommends that government through the project, should come up with the strategies thus offers grant, loans and a tax free of the SMEs, the District government should not tax those small business in order smes to grow. The researcher recommends that things like lack of Business skill, and poor management which obviously affect the expansion of firm in Musanze District, Northern Province thus government to give training curriculum, an entrepreneurship skills training and Development in place thus it can help the Smes to survive from that scenario. Many more, smes operators' in Musanze District should undertake basic training in record keeping and financial reporting or hire support staffs who are knowledgeable in these areas of accounting seriously such that they are well equipped indeed to perform in technical areas of accounting and etc efficiently in the particular areas. Specifically, the owners should pay much attention to, record keeping financial reporting and thus help them to avail accurate financial records on which decisions such as whether to continue with business or not, whether to borrow or not and whether to invest or save the proceeds can be made effectively. This can backup them to have effective control of activities effectively and efficiently.

The researcher found smes systems are not automated and this indeed exposes the smes to human errors and inaccuracies which would otherwise be corrected using appropriate technology such as accounting software's like tally and quick books to maintain accurate and reliable records thus comparing the previous financial reports with the present records.

The researcher seriously recommends use of new, updated appropriate technologies in recording and reporting to ease plans and hence to find trends of present expenditure.

Nevertheless smes owners who utilized accounting practices should review their practices on weekly basis such that to evaluate their growth thus this problem, reviews should be done on at least quarterly or semi-annually basis to relieve the business from making short-term decisions to improve on planning and controls of firm.

5.2 Further Research

The researcher gather data at smes which are operating in Musanze District, but findings could be different in some perspectives compared with other Districts in the Republic of Rwanda thus globe as whole. Indeed so far similar studies can be launch in other districts to get deep and proper details using other different designs. Apparently, in the research there is evidence of a positive correlation between record keeping, financial reporting and SMEs performance, the researcher argue that, actually in other words, it is maintaining proper record and reports in the firms that improves smes survival. The combined practices as improved customer relations, access to sustainable finance, technology diffusion, and expanding the frontiers to internal and international markets can be interesting avenues of future research.

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