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Financial Management Practices and Profitability of Modern Rice Milling Firms in Kangayam Cluster, Tamil Nadu

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Abstract

The study analyses the financial management practices adopted by modern rice milling firms in the Kangayam cluster of Tamil Nadu. For study, 40 firms were selected using simple random sampling method and data were collected through personal interviews with the owner / managers of the firm using a pre-tested interview schedule. The data pertaining to the financial performance were obtained from the records maintained by the firms for three financial years, from 2011-12 to 2013-14. The factor analysis and multiple regression analysis were carried out. Significant differences among the fully and partially modernized rice milling firms have been observed in the preparation of cash budget, setting-up credit policy, preparation of inventory budget and review of inventory turnover, capital budgeting in investment analysis and accounting practices. The measures of financial management practices explained 58.4 per cent (R-squared value) of the variation in the profitability measure return on equity.

Key words: Short-term planning, long-term planning, financial management, profitability, rice milling firms, Tamil Nadu

JEL Classification: M10, M21, G30, Q13

Introduction

India, being an agrarian economy, despite rapid growth in the industrial and service sectors, the food processing sector still plays a pivotal role accounting for about 14 per cent of manufacturing GDP, i.e. ₹ 2.80 lakh crore, and employs about 13 million people directly and 35 million people indirectly (MoFPI, 2011). Among the food processing industries in the country, the cereals processing firms have a major share in revenue, accounting for 34 per cent in 2010. Rice, the staple food across the country, has a growing demand in the market. Apart from this, the fiscal and monetary support from the government, and availability of formal credit and infrastructural support have led to a rise in the number of paddy processing firms with huge investments in technology.

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The growth in paddy processing firms has opened up opportunities for conducting research on various facets of management. In the absence of a structured finance department, the adoption of financial management practices is expected to vary among the firms and has a significant impact on profitability.

Cooley and Pullen (1979) in their study on cash management practices among the small business in United States, identified cash forecasting, investing and controlling to be the three basic elements of a cash management program. McMahon and Davies (1994) studied the financial management practices in Australia, the UK and the USA. Peel and Wilson (1996) studied the working capital management practices of small firms based in the North England dealing with the working capital components. Irala (2006) analysed the financial management practices in the Indian corporate sector and opined that it was rapidly adopting new

methodologies in financial management. Sulaiman and Ahamed (2006) conducted an overall working capital analysis and measured the efficiency in management of working capital in Kerala Agro Industries Corporation Ltd. Jain *et al.* (2007) assessed the working capital management practices of public sector enterprises in India. Alleyne and Marshall (2011) have examined the management accounting practices among the manufacturing companies in Barbados. Mensah (2012) has studied the working capital management practices of SMEs in Ghana in terms of cash management practices, receivable management practices, and inventory management practices. Abanis *et al.* (2013) have examined the financial management practices in small and medium enterprises in the selected districts of Western Uganda. The extent of financial management practices employed were measured both quantitatively and qualitatively. The efficiency of financial management practices was considered a complex and multi-dimensional construct. McMahon *et al.* (1993) reviewed the financial management practices across the countries in terms of accounting information systems, financing decisions and investing decisions. Burns and Walker (1991) examined the working capital based on cash, receivable and payable and inventory management practices.

In the literature, not much research work was available on evaluation of financial management practices in the Indian agribusiness sector. Hence, it was deemed appropriate to study this aspect to explain the financial performance of the rice milling firms. The specific objectives of study were to analyse the financial management practices adopted by the rice milling firms and to assess the impact of these practices on the profitability of rice milling firms.

Data and Methodology

The present study is based on the primary data on various financial management practices adopted and the financial performance of the rice milling firms located in the Kangayam cluster of Tamil Nadu. There are 140 modern rice milling firms in the cluster and their list was obtained from the Kangayam Taluk Rice Mill Owners' Association. Among modern rice milling firms, two distinct categories of firms existed in terms of the technology adopted by these firms. The first category of firms had partial modernization wherein some aspects of the process like soaking, testing the

moisture content at different stages, movement of materials, packing, etc., were done manually. The second category of firms were fully modernized and the entire processing activity was completely mechanized. For the study, 25 partially modernized and 15 fully modernized rice milling firms were selected using simple random sampling method. Data were collected through personal interviews with the owner / managers of the firm using a pre-tested interview schedule. Data pertaining to the financial performance were obtained from the records maintained by the firms for three financial years from 2011-12 to 2013-14.

For the present study, based on the objectives, discussions held with the owners/ managers of the rice milling firms and survey instruments applied by the previous researchers (Peel and Wilson, 1996; Nguyen, 2001; Abanis *et al.*, 2013), 16 statements pertaining to financial management practices of the rice milling firms were identified (see Annexure I). The response to each of these 16 statements was quantified on a five point Likert scale (1- Strongly disagree, 2- Disagree, 3- Neutral, 4- Agree and 5- Strongly agree). Since, a large number of variables related to financial management practices could make data analysis more complicated, the factor analysis was carried out by grouping together variables that were highly correlated and as a result simplification in analysis was ensured (Lehmann *et al.*, 1998). The factor analysis was done using the SPSS package to obtain the principal components. Each principal component was a linear combination of items of the financial management practices. The coefficients of items of financial management practices used to construct principal components were called "factor loadings". The proportion of variation explained by each principal component was estimated by dividing the sum of squared loadings (known as Eigen value) by the number of items of financial management practices. Kaiser's significant rule, which suggests that the principal components with Eigen values greater than unity should be considered statistically significant, was employed.

Multiple regression analysis was carried out to establish the relationship between financial management practices and profitability of rice milling firms. The measures of short-term planning practices (STPP), long-term planning practices (LTPP) and accounting practices (AP) were the independent variables included in the study for the financial

Table 1. Principal components of financial management practices

Particulars	Principal components		
	Short-term planning practices	Long-term planning practices	Accounting practices
Eigen value	9.46	3.33	2.65
Variance explained	47.31	22.56	17.55
Cumulative variance explained	47.31	69.87	87.42

management practices. Technology (Tech) was included as a dummy variable to examine the impact of technology (partially modernized and fully modernized) on profitability. The profitability measure, namely the Return on Equity (ROE), was the dependent variable and the model specified for the study was:

$$ROE = \beta_0 + \beta_1 STPP + \beta_2 LTPP + \beta_3 AP + \beta_4 Tech + \varepsilon$$

Results and Discussion

The individual responses for the items (statements on financial management practices) were subjected to principal component analysis with Varimax rotation using Kaiser's significance rule. The results of analysis are presented in Table 1.

Three principal components with Eigen value greater than one were retained. The first component, short-term planning practices, with Eigen value of 9.46 accounted for 47.31 per cent of variation in the original data set. The second component, long-term planning practices, explained 22.56 per cent of variation with an Eigen value of 3.33 and the third component, accounting practices, explained 17.55 per cent of variation with Eigen value 2.65. The three principal components together explained 87.42 per cent of variance.

The details of factor loadings for the financial management practices considered for further analysis are presented in Table 2.

The factor analysis resulted in seven items in the first component and it was named as short-term

Table 2. Identification of major components of financial management practices

Sl No	Financial management practices	Factor loading	Name of principal component
1	Regard for preparation of cash budget	0.862	Short-term planning practices
2	Regard to cash management practices	0.848	
3	Setup credit policy to the customers	0.853	
4	Review of debtors credit period	0.928	
5	Review percentage of bad debts	0.862	
6	Regard for preparation of inventory budgets	0.909	
7	Review of inventory turnover	0.742	
8	Applying capital budgeting techniques in decision-making	0.816	Long-term planning practices
9	Usefulness of financial ratios in financial analysis of the business	0.747	
10	Assess capital projects before investment decisions	0.681	
11	Utility of all the fixed assets acquired in the business	0.962	
12	Regard for financial planning	0.793	Accounting practices
13	Use of professional advice in capital investments	0.781	
14	Regard for accounting information system	0.745	
15	Computerization of accounting information	0.967	
16	Regard to financial reporting and analysis	0.828	

Table 3. Classification of firms based on short-term planning practices

Level of adoption	Range	Partially modernized firms		Fully modernized firms	
		Number	Per cent	Number	Per cent
Low	≤ 3.04	8	32.0	-	0.0
Medium	3.05-4.43	17	68.0	11	73.3
High	≥ 4.44	0	0.0	4	26.7
Total		25	100.0	15	100.0

Calculated Chi- square value = 11.5; Table Chi- square value = 5.99 d(f) = 2

planning practices in accordance with the items grouped under the component. Similarly, the second component with six items was named as long-term planning practices as it included majority of the items that measured long-term financial decisions of the firm and the third component with three items was named as accounting practices.

Classification of Firms on the Basis of Short-term Planning Practices

The level of adoption of short-term planning practices was measured using five point scale. The minimum and maximum scores obtained were 2.14 and 4.71, respectively. The mean score and the standard deviation was 3.74 and 0.69, respectively. The short-term planning practices was classified into three levels, namely low, medium and high. The range and relative distribution of the firms under each category are presented in Table 3.

It could be inferred that the majority of firms under both partially modernized (68.0%) and fully modernized (73.3%) categories, were under the

medium level in adoption of the short-term planning practices. Thirty two per cent of the partially modernized firms were under low level and few firms (26.7%) under the fully modernized category were under high adoption level. Significant difference among the firms was also reported by the chi-square test. The firms upon improving their short-term planning practices could move from low to medium and medium to high levels. The improvement in the short-term planning practices was expected to have a positive impact on the profitability of firms.

Short-term Planning Practices of Rice Milling Firms

The short-term planning practices adopted by the rice milling firms were represented by seven items. Their descriptive statistics and significance are discussed in Table 4.

Of the seven items categorized as short-term planning practices of the rice milling firms, four items, namely regard for preparation of cash budget, setting up of credit policy for customers, regard for preparation

Table 4. Short-term planning practices of rice milling firms in Tamil Nadu

Item	Partially modernized firms		Fully modernized firms		Z-score
	Mean	Standard deviation	Mean	Standard deviation	
Regard for preparation of cash budget	3.27	1.2	4.40	0.51	-4.13*(0.000)
Regard to cash management practices	3.83	0.95	4.00	0.65	0.67(0.5039)
Setup credit policy to the customers	3.47	0.68	4.33	0.82	-3.43*(0.000)
Review of debtors credit period	4.20	0.96	4.27	0.70	-0.26(0.7913)
Review percentage of bad debts	3.80	0.76	4.00	0.65	-0.88(0.3794)
Regard for preparation of inventory budgets	2.63	0.85	4.67	0.49	-9.64*(0.000)
Review of inventory turnover	2.76	0.65	4.27	0.68	-6.89*(0.000)

Note: Values within the parentheses indicate p-values

of inventory budgets, and review of inventory turnover, differed significantly among the partially modernized and fully modernized firms.

The mean values of the item regard to preparation of cash budget for the partially and fully modernized firms were 3.27 and 4.40, respectively. The result of the Z-test (a non-parametric test that compares two samples) shows that there was a significant difference between the two means. The fully modernized firms prepared cash budgets for different time periods, reviewed the same regularly and made interim corrections whenever needed. On the other hand, the partially modernized firms made cash planning only on weekly basis and were forced to make some ad-hoc arrangements in the case of shortages mostly through informal sources or extending the credit period from the suppliers.

In the case of setting-up of credit policy for customers, the mean values for partially modernized and fully modernized firms were 3.47 and 4.33, respectively. The results of Z-test indicated the presence of significant difference between the two means. The fully modernized firms had a practice of setting up credit policy which included the percentage of sales to be allowed as credit and credit period for each customer based on the credit worthiness and longevity of the relationship. The partially modernized firms on the other hand, were not having strict credit policy in hand. The main objective was to sell whatever was processed during the period, hence the credit policy was decided based on the stock of finished inventory, current capacity, etc., rather than based on the credit worthiness of the customers.

A significant difference was noticed between the partially modernized and fully modernized firms among the inventory management practices, namely preparation of inventory budgets and review of inventory turnover. The mean values of the items, regard for preparation of inventory budgets (4.67) and review of inventory turnover (4.27) of the fully modernized firms were under high adoption level, while the items [regard for preparation of inventory budgets (2.63), review of inventory turnover (2.76)] of the partially modernized firms were under low adoption level. Basil (2005) has also reported low levels of inventory management practices among small and medium enterprises.

However, with regard to the cash management practices like proper usage of the excess cash generated in the business and making ad-hoc arrangements to meet shortages, significant differences among the firms were not noticed because all the firms had cash-credit accounts and any excess cash was deposited in the account. Similar results were observed under the items, viz., review of debtors' credit period and review of bad debts.

The partially modernized firms should improve in all the short-term planning practices in general and the inventory management practices in particular. These firms must concentrate on preparing inventory budgets on timely intervals. As inventory forms a major part of the current assets in rice milling firms and its proper management would have a positive impact on the profitability. The firms should also constantly review the inventory turnover.

Among the fully modernized firms, except for two items, namely regard to cash management practices and review of bad debts, the mean values of rest of the items were more than 4.0. The cash management practices need improvement as majority of the firms were not investing the short-term surpluses in short-term securities either due to lack of awareness or reluctant in risk taking. Similar results were reported by Cooley and Pullen (1979) in their study among small businesses in the United States. Investing the short-term surpluses could ultimately improve the profitability. Kazooba (2006) also emphasized that the poor cash management and inadequate use of essential business and management practices were the significant reasons for failure of small and medium enterprises. Firms must introduce a proper follow up mechanism for the recovery of bad debts.

Classification of Firms on the Basis of Long-term Planning Practices

The level of adoption of long-term planning practices was measured using six items employing a five-point scale. The minimum and maximum scores obtained were 2.67 and 4.67, respectively. The mean score and the standard deviation was 3.79 and 0.549, respectively. The long-term planning practices were classified into three levels, namely low, medium and high using standard deviation and the results of analysis are presented in Table 5.

Table 5. Classification of rice milling firms based on long-term planning practices

Level of adoption	Range	Partially modernized firms		Fully modernized firms	
		Number	Per cent	Number	Per cent
Low	≤ 3.24	7	28.0	0	0.0
Medium	3.24 – 4.34	18	72.0	10	66.7
High	≥ 4.35	0	0.0	5	33.3
Total		25	100.0	15	100.0

Calculated Chi- square value = 12.57 Table Chi- square value = 5.99 d(f) = 2

It could be observed that majority of the partially modernized firms (72%) and fully modernized firms (66.7%) were under the medium level in adoption of long-term planning practices. Twenty eight per cent of the partially modernized firms were under low level and few firms (33.3%) under the fully modernized category were under high level in adoption. The chi-square test revealed the presence of significant difference between the two groups of firms.

Long-term Planning Practices of Rice Milling Firms

The analysis of individual items under the long-term planning practices provided in-depth knowledge on the practices being adopted by partially and fully modernized firms. The individual item analysis was done and the results are presented in Table 6.

Among the six items under the long-term planning practices, significant differences between partially and fully modernized firms were observed in three items.

The fully modernized firms had a qualified person or in many firms a separate department was looking after the financial aspects of the business. In such firms, application of capital budgeting techniques (Mean value: 4.33) and financial assessment of the projects before investment decision (Mean value: 4.53) were under high level vis- a-vis those of the partially modernized firms (2.77 and 3.07, respectively). Instead, the partially modernized firms often followed the peers in taking up new investment decisions rather than going for a financial assessment before investment.

Use of professional advice in capital investment also varied significantly among the groups. The fully modernized firms, for their investments on machineries, introduction of new technology and introduction of different processing methods (for example, it was observed that the fully modernized firms started producing steam boiled rice in order to increase their inventory turnover or reducing the operating cycle) consulted the subject matter specialists.

Table 6. Long-term planning practices of rice milling firms in Tamil Nadu

Item	Partially modernized firms		Fully modernized firms		Z-score
	Mean	Standard deviation	Mean	Standard deviation	
Applying capital budgeting techniques in decision making	2.77	0.94	4.33	0.62	-6.35*(0.000)
Usefulness of financial ratios in financial analysis of your business	3.37	1.03	3.80	1.26	-1.11(0.2659)
Assess capital projects before investment decisions	3.07	1.02	4.53	0.52	-6.01*(0.000)
Utility of all the fixed assets acquired in business	4.17	0.69	3.87	0.64	1.38(0.1657)
Regard for financial planning	4.23	0.73	4.40	0.74	-0.71(0.478)
Use of professional advice in capital investments	3.73	0.87	4.60	0.51	-4.00*(0.000)

Note: Values within the parentheses indicate p-values

Table 7. Classification of firms based on accounting practices

Level of adoption	Range	Partially modernized firms		Fully modernized firms	
		Number	Per cent	Number	Per cent
Low	≤ 3.09	8	32.0	0	–
Medium	3.10-4.62	15	60.0	2	13.3
High	≥4.63	2	8.0	13	86.7
Total		25	100.0	15	100.0

Calculated Chi- square value = 28.53; Table Chi- square value = 5.99; d(f) = 2

The partially modernized firms need to make use of the capital budgeting techniques in decision-making. This is mandatory as the returns from each investment may vary across firms. Since all the fully modernized firms have a computerised account maintenance system, generating the needed ratios was an easy task. But utility of these ratios in business decisions was much limited. Firms should make use of these ratios in financial analysis of the business. With regard to utility of fixed assets, fully modernized firms had installed certain machineries that were not put to use currently and hence the score for this item was below 4.0.

Classification of Firms Based on Accounting Practices

Accounting practices adopted by the firms were determined by three items and the firms were classified into three levels, namely low, medium and high using standard deviation. The mean and standard deviation of the items were 3.86 and 0.76, respectively. The classification of the firms is presented in Table 7.

It is evident from Table 7 that the majority of partially modernized firms (60.0%) were under the

medium level category in adoption of accounting practices. In contrast, the majority of fully modernized firms (86.7%) were under the high adoption level category. The chi-square test depicted the presence of significant difference in accounting practices between partially and fully modernized firms.

Accounting Practices of Rice Milling Firms

Since item-wise analysis of the accounting practices helps in understanding the parameters that differentiate the two sample groups, the mean and standard deviations of the items were analysed and the results are presented in Table 8.

The Z-test identified a significant difference between the two groups of firms in terms of computerisation of accounting information. All the fully modernized firms had computerised their entire accounting operations. The regard for accounting information also differed significantly between the two groups of firms.

Computerisation of account maintenance system was highly beneficial for the fully modernized firms in terms of reviewing the position of inventory,

Table 8. Accounting practices of rice milling firms in Tamil Nadu

Item	Partially modernized firms		Fully modernized firms		Z-score
	Mean	Standard deviation	Mean	Standard deviation	
Regard for accounting information system	4.03	0.669	4.60	0.507	-3.0451* (0.0023)
Computerization of accounting information	2.83	1.117	4.80	0.414	-7.9546* (0.000)
Regard to financial reporting and analysis	3.67	0.922	4.27	0.594	-2.5016 (0.0124)

Note: Values within the parentheses indicate p-values

Table 9. Impact of financial management practices and financial characteristics on profitability of rice milling firms
(N=40 firms)

Particulars	Co-efficient	P- value	Standard error
Intercept	-0.791	0.001	0.221
Technology	0.526**	0.0015	0.195
Short-term practices	0.141**	0.004	0.365
Long-term planning practices	0.0975*	0.012	0.367
Accounting practices	0.0647	0.573	0.359
R ²	58.40		

Note: * and ** denote significance at 0.05 per cent and 0.01 per cent levels, respectively

payables and receivables on a regular basis. It also helped in easy reconciliation of the transactions with bank statements. The preparation of financial statements became easy, as all the transactions were recorded instantly. The financial management practices of partially modernized firms could be improved by adopting computerised accounting system. Palmer (1994) had reported that only 33 per cent of the small independent retail owner-managers used computerised accounting systems. Fully modernized firms should make use of the financial statements and ratios in decision making process.

The partially modernized firms were lacking in the preparation of inventory budgets and reviewing the inventory turnover among the short-term planning practices and in applying the capital budgeting techniques in long-term planning practices. Computerisation of accounting information would improve the financial management practices of the rice milling firms. Fully modernized firms had computerized all the accounting information and were lacking in application of the financial ratios in decision-making.

Impact of Financial Management Practices on Profitability of Rice Milling Firms

An attempt was also made to find the impact of financial management practices on the profitability measured in terms of return on equity (dependent variable) of the firm. Technology was introduced as a dummy variable to take care of the level of modernization — partial or full. The results of multiple regression analysis are presented in Table 9.

The independent variables (measures of financial characteristics and financial management practices) explained 58.4 per cent of the variation in return on equity. The dummy variable technology had a significantly positive relationship with profitability.

The short-term planning management practices had a highly significant positive relationship with return on equity. Similar findings were reported by Abanis *et al.* (2013). The long-term planning practices had a significant positive relationship. The accounting practices had a positive relationship with profitability measure, i.e., return on equity but it was not significant.

Butt *et al.* (2010) have reported a positive and significant impact of capital structure decision, dividend policy, investment appraisal, working capital and financial performance assessment on organizational performance. Nguyen (2001) in his study on small and medium enterprises has reported that short-term planning practices, long-term planning practices and financial information system practices have a highly significant positive relationship with profitability.

Conclusions

The study has revealed that the majority of partially modernized (68.0%) and fully modernized rice milling firms (73.3%) were under the medium level in adoption of short-term planning practices. Thirty-two per cent of the partially modernized firms were under low adoption level and few firms (26.7%) under the fully modernized category, were categorized under high adoption level in terms of short-term planning practices.

The majority of partially modernized (72.0%) and fully modernized rice milling firms (66.7%) were under the medium level in adoption of the long-term planning practices. Twenty-eight per cent of the partially modernized firms were under low adoption level and few firms (33.3 %) under the fully modernized category, were categorized under high adoption level in long-term planning practices. The majority of partially modernized firms (60.0 %) had medium level of adoption on accounting practices. In contrast, the majority of fully modernized firms (86.7 %) were under the high level category. This significant difference between the two groups was confirmed by the chi-square test. The measures of financial management practices explained 58.4 per cent (R-squared value) of the variation in the profitability measure return on equity.

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Data Bank on Economic parameters of the Food Processing Sector, mofpi.nic.in

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Annexure I**Statements on financial management practices adopted by rice milling firms in Tamil Nadu**

S.No	Items
1.	Cash budget is prepared periodically
2.	Cash management practices are adopted in the business
3.	Credit policy is set to all the customers
4.	Review of debtors credit period is done periodically
5.	Review of percentage of bad debts is done periodically
6.	Inventory budgets are prepared by the business
7.	Inventory turnover is reviewed periodically
8.	Capital projects are assessed before investment decisions
9.	Financial ratios are used in financial analysis of the business
10.	Capital budgeting techniques are applied in decision making
11.	All fixed assets acquired in the business are fully utilized
12.	Firm does financial planning
13.	Professional advice is engaged in capital investments
14.	High regard is placed on accounting information system
15.	All the accounting information are computerized
16.	High level of regard is placed on financial reporting and analysis
