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An Empirical Study of Factors that Determines the Effectiveness of Internal Control System on Operational Performance in SMEs in Malaysia

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Introduction

This research focuses mainly on the concept of internal control and how it can affect the operational performances in Small and Medium size Enterprises (SMEs) in Malaysia. The main purpose organizations establish internal control systems is to help them achieve organizational goals; prevent wastage of resources and proper production of reliable reports which are according to rules and regulations. Internal control systems can help SMEs have a better awareness to risk and help to develop a better risk warning mechanism for every business transaction that takes place, financing and usage of resources and proper internal management. In our research, we are investigating the effectiveness of internal control on the performance in SMEs and ensuring most of the SMEs are aware and informed that effectiveness of internal control in their business operation. Most of the SMEs lacks of the awareness regarding the usefulness of internal control in their business. According to the Census Report on SMEs 2011, Malaysia has total 645,136 SMEs operation business. (www.smeinfo.my).

Problem Statement

Most of the SMEs lacks of the awareness regarding the usefulness of internal control in their business. According to the Census Report on SMEs 2011, Malaysia has total 645,136 SMEs operation business (www.smeinfo.my). Most of the SMEs believe that the implementation of internal control could plug unnecessary due to variety of loopholes. Due to complexity in setting internal control in running operations (Nyakundi, 2014), SMEs refuses to adopt an internal control system rather than having poor management of internal control. In this research, we concise about the aspect of internal control which measure in performance of business and increase the awareness among SMEs.

Research Objective

- (i) To investigate the role of entrepreneur skill as an internal control factor on operational performance in SMEs Malaysia.
- (ii) To identify the role of information technology controls as an internal control factor on operational performance in SMEs Malaysia.
- (iii) To determine the role of internal control activities as an internal control factor on operational performance in SMEs Malaysia.
- (iv) To examine the role of managerial skill as an internal control factor on operational performance in SMEs Malaysia.

Implication of Study

To provide the insight to managerial personnel being able to supervise various essential skills and closely analyse the capabilities of the organization and to have a better understanding regarding the requirement of implementation of internal control system in terms of cost, technicians, or any maintenance in certain periods.

Literature Review**Entrepreneurial skill**

Characteristic such as creativity, initiative, perseverance, self-confidence, propensity to take risk, and internal locus of control (Njaramba & Ngugi, 2014). According to Akande (2012), strategic entrepreneurial skill have a significant effect on the dominant motivators, arrange task based on different personalities employees stay engaged, motivated and happy with their work (McClelland, 1961) and provide a clear picture of all employees suitable tasks on SMEs performance. According to Mohammed & Obeleagu-Nzelibe (2014), entrepreneurial skills are significantly related to the improvement of SMEs performance. According to Lincoln (2014), entrepreneurial skill act as the attributes required for an entrepreneur to start and successfully manage a business in a competitive environment.

Information Technology controls

Information technology controls, which are designed and implemented to support the achievement of financial reporting objective (Teleket & Berhanu, 2009). According to Yang, Lin, & Koo (2011), the adaptability of computerized internal controls has significant effect on the efficiency of internal controls and operating performance. According to Tippayawong, Patitad, Sopadang, & Enkawa (2010), company with high level of technology intensity has better operational performance. According to Tarute & Gatautis (2014), ICT play a major role in innovation performance of SMEs and has a positive effect on SMEs performance.

Internal Control activities

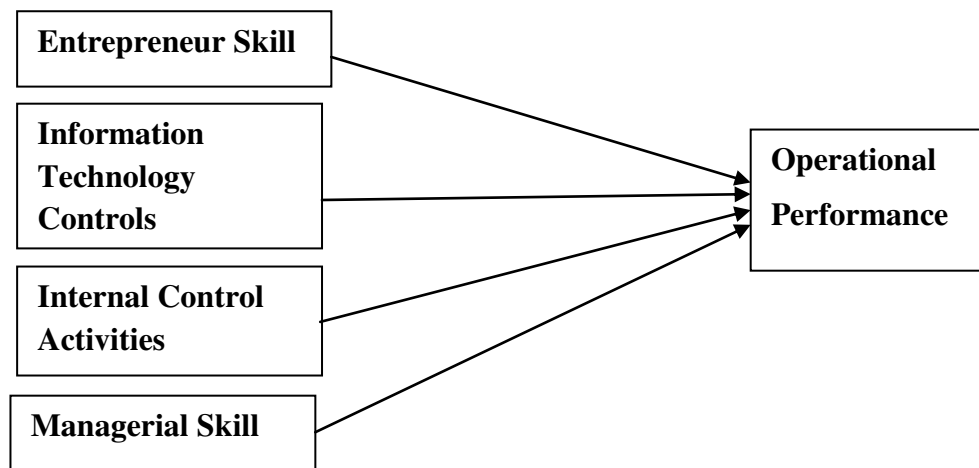
Internal control activities such as tools, techniques, procedures, and policies that can help to ensure management's directives are carried out (Adewale & Afolabi, 2014). According to Ajonbadi, Lawal, Badmus & Otokiti (2014), financial control tools are significantly related to the organizational performance. According to Teleket & Berhanu (2009), the five components of internal control are the essential attributes of an effective internal control

system for SMEs. Duréndez & Garcia (2008), the implementation of management control systems are positively related to the operational performance of young SMEs.

Managerial skill

Managerial skill is defined as competent management as an approach to manage people for full utilization of available resources for the continuous achievement of organizational goals and objectives (Ngugi, 2014). According to Kinyua (2014), management skills are positively and significantly influence the performance of SMEs. Olowu & Aliyu (2015), managerial skill have significant effect on the performance of SMEs. According to Kamunge, Njeru, & Tirimba (2014), managerial skill and experiences have significant influence on business performance of SMEs.

Proposed conceptual model



Adopted from sources: Njaramba and Ngugi (2014), and Teketel and Berhanu (2009).

Hypotheses development

- H1: There is a significant relationship between entrepreneur skill and operational performance in SMEs industry in Malaysia.
- H2: There is a significant relationship between information technology controls and operational performance in SMEs industry in Malaysia.
- H3: There is a significant relationship between internal control activities and operational performance in SMEs industry in Malaysia.
- H4: There is a significant relationship between managerial skill and operational performance in SMEs industry in Malaysia.

Methodology

The target populations are the financial controllers, managers and the managing directors of SMEs in Malaysia. The samples are chosen from the SME Corp directory and questionnaires were distributed. Since the ideal sample size is in the range of 100-200 (Forza & Filippini, 1998), so 200 samples were used for this research. The samples are taken from SMEs in Selangor (19.5%), Kuala Lumpur (13.1%) and Johor (10.7%) based on the three highest percentages of SMEs in Malaysia (Economic Census, 2011). Simple random sampling technique is used in this research because it creates a fair way of selecting samples (Bongani, 2013; Njaramba, 2014). Pearson correlation coefficient and multiple linear regression analysis techniques are used for this research.

Data analysis

Demographic analysis

	Gender
Female	68
Male	132
	Job Position
Managing Director	91
Financial Controller	56
Manager	53
	The Number of Employees
Less than 5 Employees	57
5 to 19 Employees	63
20 to 50 Employees	54
51 to 150 Employees	26
Years	Length of Time with Current Organization
Less than 1 Year	1
1 to 2 Years	16
3 to 5 Years	25
5 to 10 Years	44
10 to 20 Years	102
Above 20 Years	12

Reliability Test

Variable	Number of Item	Cronbach's alpha
Entrepreneur Skill	5	0.784953
Information Technology Controls	5	0.789735
Internal Control Activity	5	0.810152
Managerial Skill	5	0.819146
Operational Performance	6	0.844330

Pearson Correlation Analysis

Variables	ES_Avg	T_Avg	CA_Avg	MS_Avg	OP_Avg
ES_Avg	1				
ITC_Avg	0.62652	1			
ICA_Avg	0.49769	0.52771	1		
MS_Avg	0.63311	0.62247	0.49272	1	
OP_Avg	0.59210	0.64180	0.61531	0.49713	1

Multiple Regression Analysis

F-value	52.59				
Significant of F	<.0001				
R-square	0.5189				
Adj. R-square	0.5091				
Independent variable	Beta β	t-value	Significant P-value	Tolerance	Variance inflation
Intercept	0.95580	3.71	0.0003		
ES	0.17175	2.55	0.0115	0.49565	2.01755
ITC	0.28465	4.38	<.001	0.49065	2.03811
ICA	0.11805	1.98	0.0490	0.65717	1.52167
MS	0.22769	3.54	0.0005	0.50120	1.99523

$$OP = 0.95580 + 0.17175 \text{ ES} + 0.28465 \text{ ITC} + 0.11805 \text{ ICA} + 0.22769 \text{ MS}$$

Discussions of Major Findings

There is a positive relationship between entrepreneur skill and operational performance in SMEs in Malaysia (H1). Since the p value is 0.0115, the hypotheses H1 is accepted and supported with similar past studies conducted by Akande, 2012, Mohammed & Obeleagu-Nzelibe, 2014 and Lincoln, 2014. There is a positive relationship between information technology controls and operational performance in SMEs in Malaysia (H2). Since the p values is <0.001, thus the hypotheses H2 is accepted and support with similar past studies conducted by Yang, Lin, & Koo, 2011, Tippayawong, Patitad, Sopadang, & Enkawa, 2010 and Tarute & Gatautis, 2014. There is a positive relationship between internal control activities and operational performance in SMEs in Malaysia (H3). Since the p values is 0.0490, thus the hypotheses H3 is accepted and supported with similar past studies conducted by Ajonbadi, Lawal, Badmus & Otokiti, 2014, Teketel & Berhanu, 2009 and Duréndez & Garcia, 2008. There is a positive relationship between managerial skills and operational performance in SMEs in Malaysia (H4). Since the p value is 0.0005, thus hypotheses H4 is accepted and supported with similar past studies conducted by Kinyua, 2014, Olowu & Aliyu, 2015 and Kamunge, Njeru, & Tirimba, 2014.

Conclusion

From this study, the researcher has proven that entrepreneurial skill, information technology controls, internal control activities and managerial skill are positively related to the operating performance in SMEs in Malaysia. Among all the variables, information technology controls has the most significant influence on the operational performance in SMEs in Malaysia. SMEs in Malaysia should implement and monitor the computerised internal control system effectively in order to maximise the operational performance in their respective organisations.

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