THE RELATIONSHIP BETWEEN FINANCIAL PLANNING AND THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NAIROBI CITY CENTRE KENYA

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DECLARATION

This proposal is my original work and has not been presented for a degree in any other university.

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A major research project like this is never the work of anyone alone. The contribution of many different people in their different ways, have made this possible.

First I would like to thank God for the wisdom and perseverance that He has bestowed upon me during this research project, and indeed throughout my life.

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I cannot express my gratitude in words to my family. You have been a source of my strength.

DEDICATION

This proposal is dedicated to my son Sean and my daughter Shirlene, For their patience while I was writing and only dedicating little time to them.

ABSTRACT

Small and medium enterprises have grown in importance in the global economy during the last couple of decades. Although SMEs are growing speedily they face a range of challenges which work against their progress. Lack of financial knowledge has been a major setback to SMEs progress. Inefficient financial management may damage SMEs profitability and, as a result, complicate the difficulties of SMEs. Conversely, efficient financial management will help SMEs to strengthen their profitability and, as a result, these difficulties can partly be overcome. This study was motivated by the need to investigate the financial planning practices used by SMEs and their impact on the financial performance of the SMEs.

The target population of this study was 332 SMEs operating in the Nairobi CBD. A questionnaire-based survey method was used to collect data. Data collected was mainly quantitative in nature and was appropriately analyzed using descriptive statistics, while inferential statistics involved regression and ANOVA.

The study found that most SMEs practised financial planning practises by such as periodical budget estimations, activity-based budgeting and financial analysis. These financial planning practices had positive impacts on the performance of the SMEs good maintenance of capital, managing risks, increased the efficiency of operations and expanded the capacity of the SMEs to embrace opportunities. Further financial planning has eased financial crisis, made credit accessible, reduced losses caused by human errors, provide collaterals for securing loans and act as a frame work to guide the activities of the businesses. The study recommended that awareness be created to the SMEs on the importance of the financial planning in business operations.

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ABB	: Activity Based Budget
CBD	: Central Business District
CFP	: College for Financial Planning
FPA	: Financial Planning Association
NFP	: Not For Profit
POT/F	: Pecking Order Theory/Framework
ROA	: Return On Assets
ROE	: Return On Equity
ROIC	: Return On Invested Capital
SMEs	: Small and Medium Enterprises
ZBB	: Zero-Based Budgeting

CHAPTER ONE: INTRODUCTION

1.1 Background

Small and medium enterprises have grown in importance in the global economy during the last couple of decades (Hall, 2002; Mephokee, 2004). They are not only considered to be the principal driving force of economic development but they are also regarded as vital for sustained growth in almost all economies (Garikai, 2011). Further, SMEs are a major source of employment, generate significant domestic and export earnings, contribute to the general health and welfare of economies, and are a key instrument in poverty reduction (Mephokee, 2004). For instance, SMEs constitute 99.7 % and 99 % of all employers in the United States (US) and European Union (EU), respectively. In Kenya, the SMEs sector employs 74% of the labour force and contributes over 18% of the country's gross domestic product (GDP), (Ngugi, 2012). Generally, SMEs are defined by the number of workers employed, value of assets and sales turnover (Garikai, 2011).

Despite the role played by SMEs, research shows that SMEs encounter a range of problems and even though close to one million small enterprises are established each year of the small enterprises established in a year, at least 40% of them close within one year and 80% of them will be out of business within 5 years and 96% will be closed by their 10^{th} year (Gerber, 2001).

The dynamic environment of today has forced SMEs to reorganize themselves in a bid to compete in a buyer’s market through more efficient and successful management systems, among them, financial planning practices. Research on small firms in Vietnam revealed that enterprises with a formal planning system appeared to be more profitable than those without, and also that smaller firms were less likely to have formal plans (Masurel & Smit 2000). They indicated that if any enterprise, which includes SMEs, wishes to be successful in the current market, it needs to rethink the role its planning practices play in the organisation. Hilton, Maher, and Selto claim that lack of financing resources and experience of financial management is currently one of the most serious issues (Hilton, Maher, & Selto, 2006). Inefficient financial management may damage SMEs profitability and, as a result, complicate the difficulties of SMEs. Conversely, efficient financial management will help SMEs to strengthen their profitability and, as a result, these difficulties can partly be overcome.

1.1.1 Concept of Financial Planning

Financial planning is a continuous process of directing and allocating financial resources to meet strategic goals and objectives. The output from financial planning takes the form of budgets. Understanding past performance and translating that insight into forward-looking targets to align business results with the corporate strategy is key to driving shareholder value, (Arnold, & Chapman, 2004). A budget is a detailed estimate (forecasted) of future transactions which are expressed in terms of physical quantities, money or both. The essence of a budget is that it is a target set for management to keep within, achieve or surpass it. The most widely used form of budgets is Pro Forma or Budgeted Financial Statements. The foundation for Budgeted Financial Statements is Detail Budgets. Detail Budgets include sales forecasts, production forecasts, and other estimates in support of the Financial Plan. Hilton & Gordon, (1988) defines financial planning as the adaption of the broad objectives, strategies and other plans of an organisation into financial terms.

1.1.2 Financial Performance

Performance refers to the act of performing; execution, accomplishment, fulfillment, etc. In border sense, performance refers to the accomplishment of a given task measured against preset standards of accuracy, completeness, cost, and speed. In other words, it refers to the degree to which an achievement is being or has been accomplished. In the words of Frich (2009), “The performance is a general term applied to a part or to all the conducts of activities of an organization over a period of time often with reference to past or projected cost efficiency, management responsibility or accountability or the like”. Thus, not just the presentation, but the quality of results achieved refers to the performance. Performance is used to indicate firm’s success, conditions, and compliance.

The recommended measures for financial analysis that determine a firm’s financial performance are grouped into five broad categories: liquidity, solvency, profitability, repayment capacity and financial efficiency. It is important to remember that past and present financial information are not the only factors affecting a firm’s financial performance keeping in mind the fact that monitoring the “sweet 16” measures as a group is more important than focusing on only one or two measures at the exclusion of others, (Crane, 2010).

Liquidity measures the ability of the firm/business to meet financial obligations as they come due, without disrupting the owner equity, using the market value of assets and including deferred taxes in the liabilities. Three widely used financial ratios to measure solvency are the debt-to-asset ratio, the equity-to-asset ratio (sometimes referred to as percent ownership) and the debt-to-equity ratio (sometimes referred to as the leverage ratio). These three solvency ratios provide equivalent information, so the best choice is strictly a matter of personal preference, (Crane, 2010). The debt-to-asset ratio expresses total farm liabilities as a proportion of total farm assets. The higher the ratio, the lower the performance of the firm and the greater the risk involved. Four useful measures of farm profitability are the rate of return on firm assets (ROA), the rate of return on firm equity (ROE), operating profit margin and net firm income.

Profitability measures the extent to which a business generates a profit from the factors of production: labor, management and capital. Profitability analysis focuses on the relationship between revenues and expenses and on the level of profits relative to the size of investment in the business. Repayment capacity method measures the ability to repay debt from both firm and non-firm income. It evaluates the capacity of the business to service additional debt or to invest in additional capital after meeting all other cash commitments. Measures of repayment capacity are developed around an accrual net income. Two measures of repayment capacity are the term debt and capital lease coverage ratio and the capital replacement and term debt repayment margin, (Gruber, 2007). The financial performance analysis tools include all the financial statements (balance sheet, income statements). However, financial statements do not reveal all the information related to the financial operations of a firm, but they furnish some extremely useful information, which highlights two important factors profitability and financial soundness. Thus analysis of financial statements is an important aid to financial performance analysis. Financial performance analysis includes analysis and interpretation of financial statements in such a way that it undertakes full diagnosis of the profitability and financial soundness of the business. Metcalf and Titard, (1976) claims that the financial performance analysis identifies the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and profit and loss account.

1.1.3 Small and Medium Enterprises (SMEs) in Kenya

Small and Medium Enterprises (SMEs) contribute greatly to the economies of all countries, regardless of their level of development. About 80% of the labour force in Japan and 50% of workers in Germany are employed in the SME sector. With respect to developing countries and according to the ILO/JASPA (1998), the sector made a significant contribution to the gross domestic product of Uganda (20%), Kenya (19.5%) and Nigeria (24.5%).

The term SMEs covers a wide range of perceptions and measures, varying from country to country and between the sources reporting SME statistics. Some of the commonly used criterions are the number of employees, total net assets, sales and investment level. However, the most common definitional basis used is employment, but, there is a variation in defining the upper and lower size limit of an SME (Ayyagari, Beck & Demirguc-Kunt, 2003).

Many researchers define Small and Medium Enterprises in terms of the numbers of people employed. Storey (1994), for example, defines micro-enterprises as those with 0 to 9 employees, those with 10 to 99 workforces as small business, and medium-sized enterprises as having 100 to 499 employees. Gunasekaran & Kobu (2000), however, states that Small and Medium Enterprises have to be defined within the context of the economies in which they operate. In China, annual sales revenue are used to define the size of SMEs so that small enterprises are those with annual sales revenue less than 5 million; medium enterprises are those with annual sales revenue above 5 million but less than 30 million.

In Kenya an SME can be a microenterprise, a small enterprise or a medium enterprise. A microenterprise is a business organization having a maximum of 10 employees; a small enterprise has a minimum of 11 employees and a maximum of 50; while a medium enterprise has between 50 and 150 employees (Stevenson & St-Onge, 2005). Waweru (2007) posits that SMEs in Kenya are characterized by: the ease of entry and exit; the small scale nature of activities; self-employment with a high proportion of family workers and apprentices; the little amount of capital and equipment. Further, they have labour intensive technology, low level of skills and low level of organization with little access to organized markets. Other observations by Waweru are their unregulated and competitive markets, their limited access to formal credit, the existent low levels of education and training and the limited access to services and amenities.

In Kenya SMEs operate in all sectors of the economy, that is, manufacturing, trade and service subsectors. The SMEs range from those unregistered, known as Jua Kali enterprises, to those formally registered small-scale businesses, such as supermarkets, wholesale shops and transport companies. The capital invested in SMEs varies from as little as ten thousand Kenyan shillings to about 5 million Kenyan shillings. Almost two-thirds of all SMEs in Kenya are located in the rural areas with only one-third found in the urban areas. About 17 per cent are located in Nairobi and Mombasa (Central Bureau of Statistics, 1999). Close to 70 per cent of the SMEs are in the trade sector i.e. in the buying and selling goods and commodities to generate income. SMEs in the manufacturing sub-sector accounted for 13 per cent, SMEs in the services sub-sector accounted for 15 per cent, the collective group of other service providers, such as bars, hotels and restaurants (Hospitality industry) accounted for 6 per cent. Enterprises in the construction industry accounted for less than two per cent of the total SMEs in the country (Central Bureau of Statistics, 1999).

1.2 Research Problem

Financial planning is very important survival tool both in the corporate and SMEs world. Financial planning practices should be used by all enterprises including Small and Medium Enterprises. It has also been indicated in some studies that the lack of proper planning is one of the major causes of SMEs failure (Shrader, Mulford& Blackburn 1989:58; Perry 2001:205). Financial planning assist the firms in decision making, performance management and risk management which are very important factors that are directly linked to a firm’s performance. Financial planning has direct input in a firm's performance as they are directly linked to accessibility of financial credits where creditors ask for financial planning documents to determine the creditworthiness of the firm, hence keeping off those who are lacks the same.

In the past, Small and Medium Enterprises (SMEs) were mostly concerned with both manufacturing and selling their products but their operational environment is changing by the day and there is increased competition and business challenges are cropping up every now and then. The firms have to be able to adapt to these changes through planning or else fail. According to Gibson and Cassar (2002) the management of these smaller firms have little or no understanding of the subject and those with lower educational levels are less likely to have plans. Many aspects of poor management are reported to be connected to several related issues, such as poor financial circumstances, inadequate accounting records, limited access to necessary information, and lack of good managerial advice (Gaskill *et al*., 1993).

The relationship between firms' financial planning efforts and its performance has received considerable attention However, despite the large number of studies examining this relationship; the results have been inconclusive, with findings ranging from positive relationships to no relationships to negative relationships. According to Waweru (2007), lack of budgeting and financial discipline led to failure or poor performance of SMEs. Many entrepreneurs start businesses with hardly any capital and in addition, often have little or no management training or skills. They do not know how to plan and control the activities of their businesses, and as a result they do not survive in this competitive market.

Miller and Cardinal (1994), in their study on planning concluded that "Planning was found to be strongly and positively related to growth in studies in which industry effects were controlled, an informant source of performance data was used, planning was defined as not requiring written documentation and the quality of the assessment strategy was high" (Miller & Cardinal, 1994, 1660).

It is clear from the foregoing that though there are many researches done on the area of planning and its effects on performance, but little has been done on financial planning while nothing has been done in financial planning and the performance of the firm. This study aimed to establish to what extent financial planning practices are used by SMEs and whether use of these management techniques is more likely to improve their performance. The study also sought to determine the planning and budgeting methods used and their influence on the financial performance of the SMEs in Kenya. This study sought to answer the following questions:

i. What fraction of SMEs in Nairobi City Centre uses financial planning in their operations?

ii. What are the financial planning practices carried out by SMEs in Nairobi City Centre?

iii. What are the effects of financial planning on SMEs' financial performance?

1.3 Research Objectives

The general objective of the study was to assess the financial planning services used by SMEs in Nairobi City Centre. .Specifically, the study intends to: -

i. Establish the financial planning methods used by the SMEs in Nairobi City Centre.
ii. Establish the influence of financial planning practices used on the financial performance of SMEs in Nairobi City Centre.

1.4 Value of the Study

The findings of this study will be of benefit to:

i. The Government of Kenya and other policy makers: Since SMEs are identified as a main channel of development and creation of employment in Kenya, the government will find this research significant because it will dissect one of the factors that lead to the failure and low performance among SMEs in Kenya. Once the challenges facing financial planning in the SMEs are identified, government policy makers will utilize that information as input.

ii. Owners of SMEs: They will have a channel through which they can voice the managerial challenges they experience in their businesses with regard to financial planning. After identification of the issues, the owners and the management of the SMEs will then make appropriate decisions concerning financial planning to improve financial performance.

iii. Future Researchers: Future researchers will find this study useful for it will provide insight into the influence of financial planning practices on the financial performance of SMEs in Kenya. The academic argument will then be able to go further than just identifying poor financial planning practices as a cause of failure among SME’s in the country, but provide reasons as to why they are a problem. The researchers will therefore use the findings of this research to advance related argument in future.

iv. Finance Providers: Interested parties like finance providers to SMEs will be able to come up with programs to advice and train SMEs in financial planning practices in order to turn planning into a cause of success rather than for failure.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The study reviewed various literature sources related to planning and their effect on the financial performance of a firm. This chapter represent the discussion of the theoretical and conceptual outcomes of the study.

2.2 Theoretical Review

Finance theory has made major advances in understanding how capital markets work and how risky real and financial assets are valued. Tools derived from finance theory, particularly discounted cash-flow analysis, are widely used. The following are some examples of modern financial management theories formulated on principles considered as 'a set of fundamental tenets that form the basis for financial theory and decision-making in finance' by Emery et al., (1991). Some important financial management theories among the SMEs include:

2.2.1 Agency Theory

Agency theory deals with the people who own a business enterprise and all others who have interests in it, for example managers, banks, creditors, family members, and employees. The agency theory postulates that the day to day running of a business enterprise is carried out by managers as agents who have been engaged by the owners of the business as principals who are also known as shareholders. The theory is on the notion of the principle of 'two-sided transactions' which holds that any financial transactions involve two parties, both acting in their own best interests, but with different expectations. This theory has been observed to show a few shortcomings in that: it shows information asymmetry where agents have information on the financial circumstances and prospects of the enterprise that is not known to principals; moral hazard where agents deliberately take advantage of information asymmetry to redistribute wealth to themselves in an unseen manner which is ultimately to the detriment of principals; and adverse selection where agents misrepresent the skills or abilities they bring to an enterprise, (Ang, 2000). Nevertheless, the theory provides useful knowledge into many matters in SMEs financial management and shows considerable avenues as to how SMEs financial management should be practiced and perceived. It also enables academic and practitioners to pursue strategies that could help sustain the growth of SMEs, (Matthews, & Scott, 2008).

2.2.2 Signalling Theory

Signalling theory rests on the transfer and interpretation of information at hand about a business enterprise to the capital market, and the impounding of the resulting perceptions into the terms on which finance is made available to the enterprise. In other words, flows of funds between an enterprise and the capital market are dependent on the flow of information between them, (Emery et al, 1991). For example management's decision to make an acquisition or divest; repurchase outstanding shares; as well as decisions by outsiders like for example an institutional investor deciding to withhold a certain amount of equity or debt finance. The emerging evidence on the relevance of signalling theory to small enterprise financial management is mixed. Until recently, there has been no substantial and reliable empirical evidence that signalling theory accurately represents particular situations in SME financial management, or that it adds insights that are not provided by modern theory (Emery et al.1991). Keasey et al(1992) writes that of the ability of small enterprises to signal their value to potential investors, only the signal of the disclosure of an earnings forecast were found to be positively and significantly related to enterprise value amongst the following: percentage of equity retained by owners, the net proceeds raised by an equity issue, the choice of financial advisor to an issue, and the level of under pricing of an issue. Signalling theory is recently being considered to be more insightful for some aspects of small enterprise financial management than others, (Emery et al 1991).

2.2.3 Transtheoretical Model of Financial Planning and Change

If we accept that consumers make ‘‘investment mistakes,’’ the next challenge is to apply theory to financial planning in order to change consumer behaviour. Current research attempts to apply theories from various fields to model the impact of financial planning. It often makes parallels between financial and other behaviours, such as health or risk-taking behaviours. For instance, a growing body of literature

looks at the process of changing financial practices within the context of the transtheoretical model of change (Lown 2007; Shockey and Seiling 2004).

Transtheoretical model of change provide insight into how practitioners might help individuals change their financial practices. However, their applicability is limited by differences between the field from which they originate and the field of personal finance. To begin with, the theories need to be modified to incorporate external factors (e.g., exogenous financial shocks, limited access to financial services, and changes in life circumstances) that may prevent individuals from being able to change particular financial practices. Also, when we talk about health, we can indisputably identify positive health practices. Can we say the same for financial practices? What some would consider positive financial behaviour has been deemed harmful to financial health by others (Kotlikoff 2006).

To access the role of financial planning in motivating behaviour change, researchers have focused on defining and quantifying financial success. Their efforts have been tied to program evaluation research, which models and measures the impact of financial planning on consumer behaviour (Lyons 2005; Lyons et al. 2006). It is vital for researchers and practitioners to know whether financial planning indeed changes consumers' financial practices. Of course, reality lacks the controls of a laboratory. Many other factors influence financial practices, which impair researchers' ability to isolate the impact of financial planning. Even rigorous studies that use control groups and longitudinal analysis have struggled with this issue. At best, most researchers are able to show ‘‘anticipated’’ or ‘‘planned’’ changes in financial behaviour (Lyons 2005; Lyons et al. 2006). While there is some evidence to show that planned financial behaviour may be a good predictor of actual financial behaviour (Muske and Winter 2004), more studies are needed to help develop a reliable predictor of actual behaviour change—perhaps something akin to a credit scoring model.

Researchers also have difficulty selecting appropriate outcomes that match the financial capabilities of their target audience. If inappropriate measures are selected, they may overstate or underestimate the impact that financial planning has on financial performance. This is particularly important when measuring behaviour change in low-to-moderate income populations. Many financial planning programs that target low-income consumers focus primarily on helping them increase savings and reduce debt. However, Scholz and Seshadri (2007) have used life cycle theory to show that low-income households are already behaving optimally. While we would like them to save more and build wealth, they are doing the best they can, given their financial constraints. Thus, if financial education programs ignore what theory suggests, they may fail simply because they have set infeasible goals for their target audience.

In the end, financial planning training itself rarely changes an individual’s financial circumstances. Some individuals with limited financial resources do not possess the means to meet program goals to increase savings, pay bills, and reduce debts, no matter how much financial planning training they receive. This is not to suggest that practitioners should stop fostering behavior change if individuals are unable to put it into immediate practice. Nor does it mean that researchers should stop including such outcomes and indicators in their models. However, in both research and practice, greater care should be exercised when selecting outcomes and indicators for particular target groups. And such care can be guided by how these factors are linked to theory.

2.2.4 Concept of Financial Management

Financial management is an integral part of overall management. It is concerned with the duties of the financial managers in the business firm. The term financial management has been defined by Weston and Brigham: Financial management "is an area of financial decision-making, harmonizing individual motives and enterprise goals". Thus, Financial Management is mainly concerned with the effective funds management in the business. Financial management is one of the important parts of overall management, which is directly related with various functional departments like personnel, marketing and production and covers a wide area with multidimensional approaches.

Effective procurement and efficient use of finance leads to proper utilization of the finance by the business concern (Yaser, & Amir, 1996), hence it is the essential part of the management.. Hence, the financial manager must determine the basic objectives of the financial management. Financial management has been observed to bring about profit maximization as well as wealth maximisation in the firms. Among SMEs, financial management is not widely practised due to their nature of being too small to warrant a finance manager and the lack of financial management skills by the business owners, (Masurel, & Smit, 2000). Managerial experience and financial management, seems vital in determining the success or failure of the firm.

2.3 Financial Performance

Financial measures are intended to help businesses analyse their activities from a financial standpoint and provide useful information needed to make good management decisions. By themselves, the financial measures discussed don’t provide answers—they need to be reviewed in relation to each other and to other farm and non-farm activities, (Holmes, and Kent, 1991). It is not possible to control or predict all of the factors that influence the final outcome of any farm decision. Nor is it possible to have available all of the information that would be ideal. But decision making can be improved through using available information and through effective financial planning and analysis. Crane, (2010) claims that the recommended measures for financial analysis are grouped into five broad categories: liquidity, solvency, profitability, repayment capacity and financial efficiency. These are discussed below as. He goes further to discuss them as below.

2.3.1 Liquidity

Liquidity measures the ability of the business to meet financial obligations as they come due, without disrupting the normal, on-going operations of the business. Liquidity can be analyzed both structurally and operationally. Structural liquidity refers to balance sheet measures of the relationships between assets and liabilities and operational liquidity refers to cash flow measures. A frequent cause of liquidity problem s occurs when debt maturities are not matched with the rate at which the business' assets are converted to cash. Two recommended measures of liquidity are the current ratio and working capital. The current ratio measures the relationship between total current assets and total current liabilities and is a relative measure rather than an absolute monetary measure. The higher the ratio, the more liquid the business is considered to be. Working capital is a measure of the amount of funds available to purchase inputs and inventory items after the sale of current assets and payment of all current liabilities. Working capital is expressed in absolute monetary units; therefore, determining adequate working capital is related to the size of the business operation.

2.3.2 Solvency

Solvency measures the amount of borrowed capital used by the business relative to the amount of owner's equity capital invested in the business. In other words, solvency measures provide an indication of the business' ability to repay all indebtedness if all of the assets were sold. Solvency measures also provide an indication of the business' ability to withstand risks by providing information about the business's ability to continue operating after a major financial adversity. Unlike liquidity, solvency is concerned with long-term as well as short-term assets and liabilities. Solvency measures evaluate what would happen if all assets were sold and converted into cash and all liabilities were paid. The most straightforward measure of solvency is owner equity, using the market value of assets and including deferred taxes in the liabilities. As with working capital, adequacy of equity depends on business size, making comparisons difficult without using ratios for SMEs. Three widely used financial ratios to measure solvency are the debt-to-asset ratio, the equity-to-asset ratio (sometimes referred to as percent ownership) and the debt-to-equity ratio (sometimes referred to as the leverage ratio). These three solvency ratios provide equivalent information, so the best choice is strictly a matter of personal preference. The debt-to-asset ratio expresses total business liabilities as a proportion of total business assets. The equity-to-asset ratio expresses the proportion of total assets financed by the owner's equity. The debt-to-equity ratio reflects the capital structure of the business and the extent to which a firm's debt capital is being combined with business equity capital.

2.3.3 Profitability

Profitability measures the extent to which a business generates a profit from the factors of production: labor, management and capital. Profitability analysis focuses on the relationship between revenues and expenses and on the level of profits relative to the size of investment in the business. Four useful measures of business profitability are the rate of return on assets (ROA), the rate of return on equity (ROE), operating profit margin and net income. The ROA measures the return to all assets and is often used as an overall index of profitability, and the higher the value, the more profitable the business. The ROE measures the rate of return on the owner's equity employed in the business.

2.3.4 Repayment Capacity

Repayment capacity measures the ability to repay debt from both business and non-business income. The only way for an unprofitable business to survive long-term is for income infusions from non-business sources to offset business losses. Two measures of repayment capacity are the term debt and capital lease coverage ratio and the capital replacement and term debt repayment margin. The term debt and capital lease coverage ratio provides a measure of the ability of a borrower to cover all required term debt and capital lease payments. The higher the ratio is over 1:1, the greater the margin to cover the payments.

2.3.5 Financial Efficiency

Financial efficiency measures the degree of efficiency in using labor, management and capital. Efficiency analysis deals with the relationships between inputs and outputs. Because inputs can be measured in both physical and financial terms, a large number of efficiency measures in addition to financial measures are usually possible. Five measures of financial efficiency are the asset turnover ratio, operating expense ratio, depreciation expense ratio, interest expense ratio and net income from operations ratio.

2.3.6 Available Capital and Capacity to Attract Capital

Firms need available capital and capacity to attract capital in order to operate, to enter into new ventures or to expand the firm. A properly prepared balance sheet reports the amount of cash and other liquid assets available to meet cash needs. However, most firms have access to more cash than what they currently possess or realize. Nearly all firm businesses can borrow additional cash and the capacity to borrow (often called a credit reserve) is an asset. Similarly, the ability to attract investors is an asset that deserves to be recognized. The capacity to acquire additional cash allows a firm business to undertake new or expanded activities. The financial ratios, and how they compare to similar firms, provide some indication of the business' credit reserve the cost of capital, that is, the rate of interest the business must pay a lender or the return that must be paid to an investor. The higher the interest or dividend rate, the less capacity the firm has to acquire additional capital; thus, the market interest rate directly influences a business credit reserve.

2.3.7 Capacity to Assume Risk

The opportunity for any business to earn a profit requires assuming some risk. Although not described as a business asset, the ability and willingness to assume risk is critical. Types of risk businesses encounter include production, marketing, financial, legal and human resource. A firm will likely differ in its capacity to assume each type of risk exposure. One way to consider a firm's capacity to assume risk is to describe it as a chain with five links. The first link is net earnings as a percent of the value of the firm production, which shows the firm's capacity to absorb losses resulting from reduction in yields or price. The second link is the working capital of the firm business. This indicates if the business has sufficient cash flow (and current assets) to cover operating losses that occur in the first link. The third link is current debt repayment capacity, which shows the firm's ability to rely on a carryover operating loan to finance operating losses. The fourth link is owner's equity, which is

the business' ability to sell assets to restructure its finances. The last link is collateral, which is the legal right to the owner's equity, (Crane, 2010).

2.4 Effect of Financial Planning on Financial Performance

The external and internal factors provide managers with the foundation to create a budget, which works in tandem with financial planning. Small business owners can use financial planning and budgeting to obtain external financing from investors or banks. Many small businesses need some external financing for growing operations. Because small businesses may not have a strong financial history, financial planning and budgeting helps investors or banks thoroughly review the business.

Financial planning is required to monitor and indicate the financial capability of a firm over time (Beith and Goldreich 2000) in order to most profitably operate the organization. Owners seek to maximize profits (Ginn et al. 1995) regardless of the tax status of the organization, not for profit (NFP) or investor owned (IO).

While organizations that do not generate a return on assets in excess of their cost of capital are in danger of financial failure, (Hessler 2000; Langabeer 1998) numerous areas of financial performance are often used to monitor asset productivity, (Sobol 2000). One predominant monitor of financial performance is return on invested capital (ROIC = operating margin / invested capital), also identified by Hatch and Rich (1999), which is acquire through the financial planning process. Beith and Goldreich (2000) reported in their survey of 104 "Blue Chip" hospitals, that those with credit ratings of AA (hospitals rating) or better, that the primary determinants of AA status continue to be balance sheet strength and positive earnings. Grossman (2000) indicates that credit ratings depend on an overall ability to pay creditors, which has critical implications for program planning efforts.

A company can monitor its progress against its budgets, for example, on a quarterly basis, providing it with a potent control mechanism. Frequent checks enable managers to spot early in the process whether some expenses are getting out of control and take the necessary corrective actions. It also enables senior leadership to spot trouble spots—such as weak expense controls in a particular geographic region.

Budgets should not be set in stone and need to be flexible to react to special items, ranging from a spike in borrowing costs to nonrecurring expenses to a change in regulation that might cut off a revenue stream. Management may need to update budgets and financial plans regularly to account for unanticipated events. Though some view budgets with dread and feel that they impose constraints that are hard to live with, a budget is an integral part of a financial plan. Budgets allow managers to provide investors and creditors with forward-looking guidance, and though they do not guarantee success, they certainly can help avoid costly mistakes or failure.

2.5 Empirical Studies

Levin (2001) calculates success holistically by way of a sophisticated tool developed in 1996 as a method for quantifying the success of financial planning against a client's long-term life plan. If wealth of client is a measure of success, Levin integrates all aspects of a client's resources "financial, emotional, physical, and spiritual (p. 93)." Gresham and Cooper (2001) posit a grading system for the financial planner as a tool for assessing success. Three components given by this study are: additional assets, referral business, and new business. Each component is placed into a worksheet from which the planner grades his or her success by comparing to client goals and expectations.

The FPA conducted a study on compensation and staffing in 2001 claiming personnel management in financial advisory firms in the U.S. dramatically affected the success of the financial planning firm (Tibergien & Palaveev, 2001). This study showed the delicate issues owners and financial planning managers' face when dealing with human resource tasks. The study also identified a compensation model of paying competitively within the industry across firms. In particular, advantages were found in hiring specialized financial professionals (staffing) as well as an understanding of how corporate culture can limit the growth of employees of the firm.

Peatey (2007) writes that the key to success in financial planning is the ability to provide quality service, which is ultimately dependent upon the quality of staff within the financial planning organization. Bob Veres, writing for the *Journal of financial planning* (2002) discusses important lessons of life and business stating how few they are in the article entitled "*The Eternal Determinants of Success.*" Veres states time and time management to be two of the most important keys to financial planner success. Following this article in the same journal in 2003, Veres writes of a well trodden the path within the profession (e.g., success) is hardly ever written about in a scholarly fashion (Veres, 2003).

Scholp (2004) notes that monetary gain and recognition are not the only keys that should be considered to financial planning success. Scholp's argument bridges the great divide within general career success planning by virtue of blending the objective criteria of pay, promotions, and recognition with subjective criteria such as work/life balance.

Vance (2004) provides a "Recipe for Success" rooted heavily in subject criteria. Vance states the ingredients to success as a professional in the financial planning domain are trust building with the client and giving back to the community.

Evensky (2005) reviews changes during the last 20 years within should focus on realistic planning success, such as meeting client's lifelong goals, as opposed to emphasis on performance of a portfolio. Evensky also notes success will no longer be measured by the planner's ability to outperform other planners or fund managers, but rather how well one the CFP mark. The results of this work revealed that planning professionals serving larger markets, offering more products and services, and using a commission based fee structure tend to exhibit higher income levels than those who did not exhibit these characteristics. Other contributors examined within this study were business practices such as affiliation, business structure, span of practice, operating characteristics such as method of making initial contact functions performed by the planner, and client characteristics such as income differences among clients. This study utilized an analysis with a breakpoint of $50,000 as the metric for "success." Those individuals practicing financial planning, holding the CFP designation, and reporting income greater than $50,000 were defined as successful, whereas individuals practicing financial planning, holding the CFP designation, and reporting income less than $50,000 were defined as unsuccessful.

Many financial planners chase wealth management as a tool to find success, often leaving behind other important demographic groups. Crane (2007) writing for the *Journal of Financial Planning* discusses a trend by American financial to ignore the middlle class in favor of the wealthy. Crane states this could be an inefficient path to success considering the numbers within the middle class pool. Bob Veres writes in financial planning (2007) that practice management ideas can create a productive success strategy. Veres cites management ideas such as efficient office procedures, self organizational tools and staffing methods can be a key to productivity. O'Toole (2008) lists seven disciplines that successful financial planners use in within their practice. These disciplines which include focused strategic direction, client relationship management strategy, and business development strategy help the planner examine strengths, create capacity and establish efficiency within business practices.

The financial planning landscape is becoming more competitive as evidenced not only by the sheer number of financial planners or advisors operating today but also by the attention the competitive landscape is receiving within the popular press. Duey (2008) offers ideas for financial planners in an effort to better compete within the financial planning profession. The ideas and tips are built on the premise that the planner has first chosen the correct career path. Duey states planners must position themselves in the career by way of a systematic process complete with mentoring, building contacts and referrals, relationships and trusts, as well as getting involved with the community.

Leyes (2006), states the key to success lies within three principle things: 1) successful people know their purpose in life, 2) success means growing to your maximum potential, and 3) success means sowing seeds to benefit others. In this way, one can understand that success, even for financial planners is something that must occur over time within a cultivation framework and mindset. Gunz and Heslin (2005) show a cursory search of the literature in general terms yields literally thousands of books and articles about career success in many different formats. More specifically, within financial planning there are many different ideas regarding the perception of success as a financial planner.

2.6 Summary of the Literature Review

This chapter has presented the theories which educate on financial planning.

The agency theory gives useful knowledge into many matters in SMEs financial management and shows considerable avenues as to how SMEs financial management should be practiced and perceived.

The Signalling theory informs on how an enterprise and the capital market are dependent on the flow of information between them while the Transtheoretical model of change explains on how SMEs change their financial behaviours and practices. All these theories are under the umbrella of the concept of financial management.

The chapter also reviewed the concept of financial management and its importance in the management of the enterprises. The financial performance of the SMEs can be measured using liquidity, cases off solvency, the profitability, ability of a business to repay back credit balances, financial efficiency, the size of the capital and the ability of an enterprise to assume risks.

Several studies have been reviewed which studied financial planning such as (Levin, 2001; Tibergien & Palaveev, 2001; Peatey, 2007; Veres, 2003; Scholp, 2004; Leyes; 2006). There is review on the effects of the planning on financial performance and lastly a review on the indicators for measuring the financial performance. However, these studies have not addressed the effect of financial planning on the SMEs financial performance. Thus gap in knowledge exists in the literature on the relationship between financial planning and the financial performance of the SMEs.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

A study of the research method was important in ensuring that the methodology that was adopted was sound. This chapter looked at the research method and how it was used. It concentrated on the research design, details on the target population, data collection instrument and data analysis.

According to Coopers and Schindler (2003) descriptive research design serves a variety of research objectives such as descriptions of phenomenon or characteristics associated with a subject population, estimates of proportions of a population that have these characteristics and discovery of associations among different variables. This study adopted a descriptive study that described the population using measures of central tendencies' such as mean, mode and median, and measures of dispersion and distribution, (Mugenda and Mugenda, 2003).

3.2 Population

The population of the study were all the registered SMEs in Nairobi City Centre. According to Kenya Business list there are 332 SMEs in Nairobi City Centre. The SMEs employing 1-50 persons were chosen for the study.

3.3 Sample Design

A representative sample of 99 SMEs was acquired from the population using stratified probability sampling. Mugenda and Mugenda (2003) claims that a representative sample of at least 30 respondents is a good representative sample of a population which does not exceed 10,000 respondents. They also claimed that a sample of 10% is adequate and representative enough for the whole population. This study used 30% which is higher than 10%. The sample size was therefore 99 of the total SMEs. The period of study covered 5 years from 2009 to 2013.

3.4 Data Collection

The study incorporated self-completion data collection method where all the identified respondents were given a questionnaire to complete and follow-up was made to ensure that there was an adequate completion rate. The instrument was a semi-structured questionnaire having both open and close-ended questions.

Data on financial planning was collected using questionnaires filled by the SMEs operators while data on the financial performance was gathered from past records and financial statements of the businesses which took part in the study.

A questionnaire was used to collect data on the financial planning practices because it was a first time data which could only be gotten from the respondents. Te questionnaire also saved time and was economical to administer. Secondary data on performance was collected through a questionnaire and also financial records of the

SMEs. The records of the businesses showed the previous performance of the enterprises which could only be gotten from the secondary sources.

3.5 Data Analysis

Since the instrument of choice for this research was a semi-structured questionnaire, data collected were both quantitative and qualitative forms. The analysis was done to establish the measures of central tendency that include the mean, mode, and median highlighting the key findings.

Inferential statistics were used to establish the relationship between the variables of the study and qualitatively by content analysis. Analysis of variance (ANOVA) was used to determine the significance relationship of the variables. The study used regression to study how the financial planning affect the financial performance.

Financial performance indicators are usually in form of ratios and they cover a number of concepts and are grouped as profitability, liquidity, Utilization, Financial strength and investment. For the purpose of this study, financial performance which is the dependent variable, was measured by the levels of profits realised. The study used the levels of profits accrued by the SMEs within the study times to measure the financial performance. Moreover, financial performance was also measured using mean and standard deviation to study the aspects related to financial performance.

The independent variable operationalized the financial planning strategies which included: Periodical Budget creation, Creation of financial statements, Business Proforma creation, Activity based budgeting and Financial analysis. These were measured by the frequency which the SME used these financial planning tools in running their operations and the review of these tools to monitor their efficiency.

All the independent variables were measured using mean and standard deviation within a range of five points. The data collected was averaged in a scale of 5 points. Then the resultant values were considered in drawing of the conclusions.

This study adopted a linear regression model to test the relationship between the variables in financial planning as the independent variable and financial performance of SMEs as the dependent variable.

$$Y= \beta_0+ \beta_1X_1+ \beta_2X_2+ \beta_3X_3+ \beta_4X_4+ \beta_5X_5+\varepsilon$$

Where Y= Financial Performance

β_0 = intercept

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ = coefficients

X_1 = Periodical budget creation

X_2 = Creation of financial Statements

X_3 = Business Proforma creation

X_4 = Activity based Budgeting

X_5 = Financial Analysis

ε = error term

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the findings and presentations of the data collected using methodologies discussed in chapter three. The chapter provides demographic data of the respondents, the extent by which SMEs practise financial planning, the financial planning activities practised by the SMEs, financial controls of the SMEs used and effects of the financial planning activities on the performance of the SMEs.

4.1.1 Response Rate

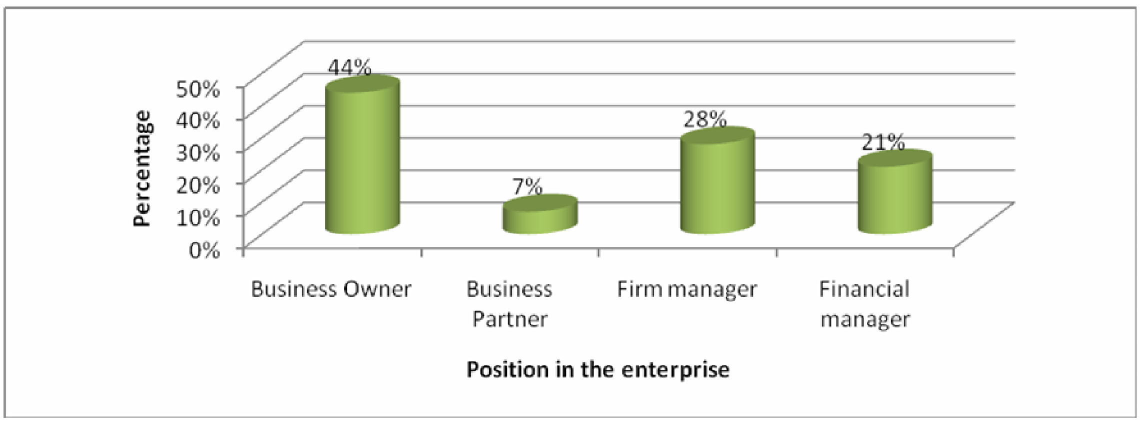
The study administered a total of 99 questionnaires to different enterprises in Nairobi City Centre. Out of the 99 questionnaires administered, 76 were collected fully filled and were used in the study. This represents a response rate of 76.76%. According to Mugenda & Mugenda (2003) a response rate of 50% is adequate for a study, 60% is good and 70% is excellent for a study. Therefore this response rate was considered ideal and reliable for the study.

4.2 Demographic Information

4.2.1 Position in the enterprise

The study collected data on the position of the respondents who took part in this study. The findings are found in figure 4.1.

Figure 4. 1 Position in the enterprise

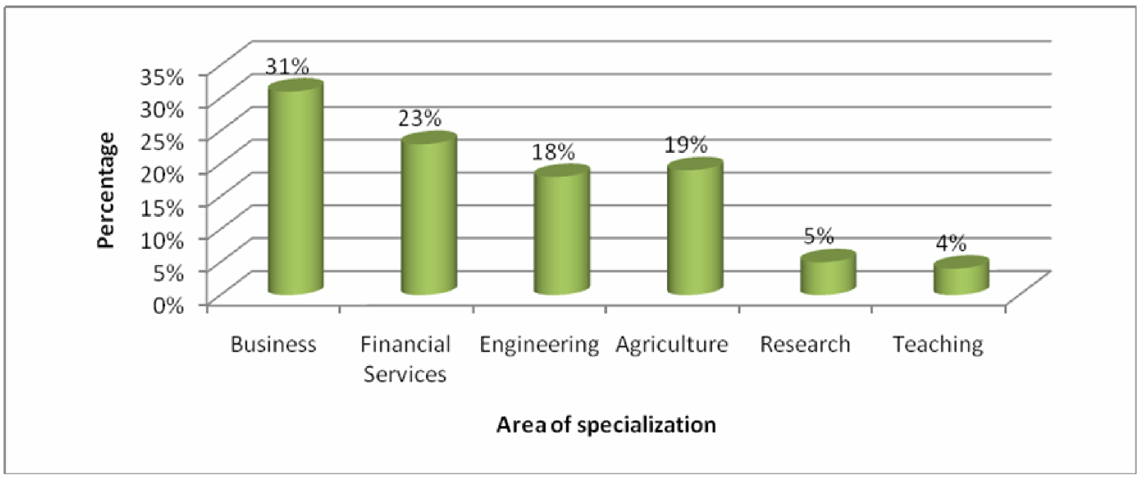


The information contained in figure 4.1 shows that most of the respondents who took part in this study, were the business owners of their enterprises (44%). Approximately 28% of the respondents were firm managers of the enterprises (28%), 21% were financial managers and 7% were business partners. Thus the respondents who took part in this study had superior knowledge of their business.

4.2.2 Area of specialization

The study collected data from different types of enterprises who had businesses in Nairobi City Centre. The findings are shown in figure 4.2.

Figure 4. 2 Area of specialization

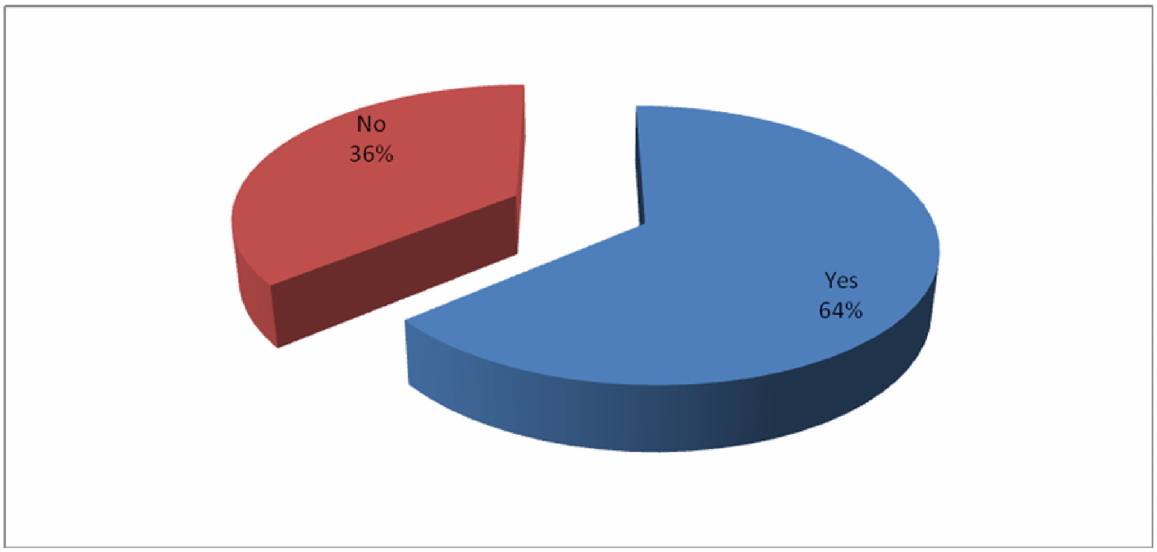


The information summarised in figure 4.2 shows the different types of enterprises which the study collected data from and were operating in Nairobi City Centre at the time of the study. From the findings, most of the enterprises were general stores for sale of goods (31%), 23% were financial enterprises, 19% were veterinary shops and other farm inputs while 18% were from engineering.

4.3 Percentage of the Firms doing Financial Planning

The respondents were requested to indicate whether their firms do financial planning. The results are shown in figure 4.3.

Figure 4. 3 Percentage of the firms doing financial planning



The information found in figure 4.3 shows the proportion of the enterprises which practised financial planning in their future operations. From the results shown, Majority of the enterprises (64%) used to do some planning on their finances while about 36% did not do thorough financial planning.

4.4 Financial Planning Activities among the SMEs

The various financial planning activities carried out by the enterprises were studied. The study collected data using linkert scale and analysed it using descriptive statistics such as mean and standard deviation. According to the scale, those variables which had a mean close to 4.0 represented 'great extent', those which had a mean close to 3.0 represented 'moderate extent' while those which had a mean close to 2.0 represented 'low extent'. Standard deviation was used to indicate the extent of dispersion and subsequently consensus.

Table 4. 1 Financial planning activities among the SMEs

	Mean	**Std. Dev**
Periodical Budget estimations	4.2	0.8
Creation of financial statements	3.4	0.7
Business Proforma creation	2.7	0.9
Activity based budgeting	4.1	0.6
Financial analysis	4.0	0.7

The information contained in table 4.1 shows the extent to which financial planning practices were adopted by SMEs in Nairobi City Centre. According to the findings, the respondents adopted to a great extent periodical budget estimations (M=4.2), activity based budgeting (M=4.1) and financial analysis (M=4.0). The SMEs created financial statements moderately (M=3.4) and business proforma (M=2.7). These functions are mainly carried out by the business owners for the small enterprises or managers for the medium enterprises.

4.5 Financial Controls

The study established some activities which are meant to control the activities of the SMEs. The established financial systems are shown in table 4.2. The study collected data using likert scale and analysed it using descriptive statistics such as mean and standard deviation. According to the scale, those variables which had a mean close to 4.0 represented ‘great extent’, those which had a mean close to 3.0 represented ‘moderate extent’while those which had a mean close to 2.0 represented ‘low extent’. Standard deviation was used to indicate the extent of dispersion and subsequently consensus.

Table 4. 2 Monitoring Activities

	Mean	**Std. Dev**
Recording the transactions of your business	4.1	0.8
Comparing cost and selling prices before buying stocks	4.2	0.9
Monitoring stock levels	3.8	0.6
Setting profit target periodically	2.4	0.5

The data results shown in table 4.2 shows the findings on some of the monitoring activities carried out by some of the SMEs in Nairobi. From the findings, the study found that the SMEs recorded the transactions of their businesses (M=4.1) and compared costs and selling prices before buying stocks (M=4.2). For those SMEs which deal with products determine the stock levels (M=3.8) to a great extent. In general, the study found that most SMEs do not set profit targets (M=2.4).

4.6 Time Intervals between Reviews on Financial Practices

The study collected data on the period taken by the SMEs to do reviews of their financial practices. The results are shown in table 4.3.

Table 4. 3 Time intervals between reviews on financial practices

	Monthly	Quarterly	Biannually	Annually	Biennially	2-5 years	Never
Budgeting	2%	6%	32%	60%	-	-	-
Proforma creation	-	-	-	35%	-	20%	45%
Income Statement Creation	-	8%	32	60%	-	-	-
Balance sheet creation	-	8%	30%	62%	-	-	-
Financial Analysis	-	10	25	65%	-	-	-

The data contained in table 4.3 shows the time intervals taken by the SMEs to make reviews of their financial planning practices. From the findings, budgeting is done annually by most of the SMEs (60%), profoma creation is not very commonly done by most of the SMEs but those who do so do it on annual basis. Other financial practices such as creation of financial statements (60%), drawing of balance sheets (62%) and financial analysis (65%) are mainly done annually though other SMEs did it biannually.

4.7 Financial Planning and Performance

The study collected information on the effect of the financial planning practices on the performance of the SMEs. The results are shown in 4.4.

Table 4. 4 Effects of Financial Planning on Performance

	Mean	**Std. Dev**
Capital Availability	4.1	0.6
Liquidity of the firm's Assets	3.1	0.7
Risk Management	3.8	0.9
Efficiency	4.2	0.7
Capacity to Attract Capital	3.2	0.8
Capacity to Embrace Opportunities	.3.6	0.6

From table 4.4, the use of sound financial planning practices is key and critical for the performance of the enterprises. The study established that sound financial planning practices have very positive impacts on the performance of the firms. According to the findings, financial planning practices helps companies to keep capital (M=4.1), to improve on risk management (M=3.8) and improve efficiency of the SMEs (4.2). Further, the study found that financial planning builds capacity of the SMEs to embrace opportunities (M=3.6).

4.8 Financial Planning and Firm Operations

The study collected data on the firm performance of the SMEs. The findings are shown in table 4.5.

Table 4. 5 Effect on the firm operations

	Mean	**Std. Dev**
Eased financial transactions	4.2	0.4
Eased Access to credit	4.3	0.8
Minimized cost in auditing	3.1	0.9
Minimized loss of cash during handling	3.8	0.7
Improved Efficiency the business	4.3	0.6
Increased returns through increased efficiency	4.1	0.8
Increased ability to attract shareholders	3.2	0.7

The effect of sound financial planning practices was evident and very positive. According to the findings, the financial planning practices have to a great extent eased financial transaction crisis (M=4.2), have eased access to credit (M=4.3) and minimised loss of cash during handling (M=3.8). Further, the financial practices have improved the efficiency (M=4.3) and increased the returns as a result of increased efficiency (M=4.1). However, financial planning practices had little impact on the cost of auditing (M=3.1) and ability to attract shareholders (M=3.2).

4.9 Effects of Financial Planning on the Performance

To study the effects of the financial planning practices on the performance of the SMEs, the study run a linear multiple regression test to establish the effects of each of the practices. The findings are discussed in the following sections.

Table 4. 6 Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.587(a)	.344	.269	37.20627

The findings shown in table 4.6 shows the extent of variations on the profits which are explained by the independent variables. The R square value is 0.344. This means that the independent variables explain 34.4% of the variations in dependent variable. The rest 65.6% are explained by other factors.

Table 4. 7 ANOVA

	Sum of	df	Mean Square	F	Sig.

	Squares				
Regression	25453.840	4	6363.460	4.597	.004(a)
Residual	48450.731	35	1384.307		
Total	73904.571	39			

The data findings in table 4.7 show that the independent variables are statistically significant in predicting the financial performance of the SMEs. The study established a significant value of p=0.004 showing a statistical significance relationship.

Table 4. 8 Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-39.619	23.043		-1.719	.094
Periodical Budget estimations	18.500	6.352	.514	2.912	.006
Creation of financial statements	7.801	8.808	.200	.886	.0382
Activity based budgeting	8.813	7.704	.249	1.144	.0260
Financial analysis	3.096	4.417	.118	.701	.0488

The data findings in table 4.8 show the coefficients of the regression test. According to the findings, Periodical Budget estimations (P=0.006), creation of financial statements (p=0.0382), activity based budgeting (p=0.0260) and financial analysis (p=0.0488) were all significant in predicting the profits of the SMEs since all the p values were less than 0.05.

The resulting regression model was:

Y (profits) = -39.619+ 18.500 Periodical Budget estimations + 7.801 creation of financial statements + 8.813 activity based budgeting + 3.096 financial analysis.

The findings indicate that when all the factors are held constant the profits will decline by -39.619 units. When all the factors are held constant one unit use of Periodical Budget estimations increases the profits by 18.5 units. When all the factors are held constant a unit increase in the use of creation of financial statements increases the profits by 7.801 units. Similarly, a unit increase in the use of activity based budgeting holding other factors constant increases the profits by 8.813 units. A single financial analysis holding the rest of factors constant increases the profits by 3.096 units. This shows that the use of financial planning practices have had a great impact on the performance of the SMES in terms of profitability.

4.10 Discussion and interpretation of the findings

The study found that majority of the enterprises (65%) operating in Nairobi City Centre do some financial planning practices in their operations. However, a proportion of about 36% did not do formal financial planning according to the study results. According to a study by Masurel & Smit (2000) in Vietnam, enterprises with a formal planning system appeared to be more profitable than those without, and also that smaller firms were less likely to have formal plans. This means that SMEs which have no formal financial planning are likely to be less profitable in Nairobi City Centre.

According to Arnold, & Chapman (2004) financial planning is understanding past performance and translating that insight into forward-looking targets to align business results with the corporate strategy is key to driving shareholder value. The study shows that SMEs operating in Nairobi City Centre practised to a great extent three main types of financial planning: periodical budget estimations (M=4.2), activity based budgeting (M=4.1) and financial analysis (M=4.0). To a moderate extent the SMEs keep records and prepare financial statements (M=3.4). The SMEs do not prepare business profomas (M=2.7) which predisposes them to risk and volatility. Hilton & Gordon, (1988) defines financial planning as the adaption of the broad objectives, strategies and other plans of an organisation into financial terms.

The study findings show that most of the SMEs had some control activities which helped their business to operate smoothly. The study result shows that SMEs to a great extent recorded their transactions (M=4.1). This helped them in maintaining their records up to date. The study also found that SMEs used to compare costs and selling prices before buying stocks to a great extent (M=4.2). This helped them not to buy the products and goods which made low profits and also prevented them to avoid goods which had high holding costs with little profits. More importantly, the study found that SMEs used to determine the stock levels of their businesses and monitored their fluctuations (M=3.8) which ensured that their stock levels were maintained at safe levels. In contrary, the study found that most SMEs did not set their profit target (M=2.4).

The findings of this study shows that budgeting was done annually by majority of the SMEs (60%). Although proforma creation was not very common among SMEs, the study found that those SMEs which prepared them, considered annual time intervals before preparing others. Approximately the study found that 60% of the SMEs prepared financial statements on annual basis, 62% prepared balance sheets after a period of one year 65% did their financial analysis annually and some few biannually. This show that financial planning practices were done in intervals of one year.

The study findings shows that financial planning practices helped companies to keep capital (M=4.1), to improve on risk management (M=3.8) and improve efficiency of the SMEs (4.2). Financial planning practices also builds capacity of the SMEs to embrace opportunities (M=3.6) to a great extent. Metcalf (1976) claims that the financial performance analysis identifies the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and profit and loss account

Other benefits realised from financial planning included easing financial transaction crisis (M=4.2), eased accessing of credit to the SMES (M=4.3) and minimised loss of cash during handling to a great extent (M=3.8). Further, the financial practices have improved the efficiency (M=4.3) and increased the returns as a result of increased efficiency (M=4.1). However, financial planning practices had little impact on the cost of auditing (M=3.1) and ability to attract shareholders (M=3.2). Waweru (2007) posits that SMEs in Kenya are characterized by: the ease of entry and exit; the small scale nature of activities; self-employment with a high proportion of family workers and apprentices; the little amount of capital and equipment.

The study had a R square value of 0.344 indicating that the selected financial planning practices explained 34.4% of the financial performance of the SMEs operating in Nairobi City Centre at the time of the study. The realised ANOVA value was F= 4.597, p=00.4. Thus the financial planning practices were very significant on the financial performance of the SMEs operating in Nairobi.

The study found that Periodical Budget estimations (P=0.006), creation of financial statements (p=0.0382), activity based budgeting (p=0.0260) and financial analysis (p=0.0488) were all significant in predicting the profits of the banks since all the p values were less than 0.05. Further the study established that financial planning practises such as periodic budget estimations, creation of financial statements, activity based budgeting and financial analysis were all positively related to the performance of the SMEs.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings of the study, conclusions and the study recommendations. The chapter also has a section which makes suggestions for further study.

5.2 Summary of the Findings

The study found that majority of the enterprises (65%) operating in Nairobi City Centre do some financial planning practices in their operations. However, a proportion of about 36% did not do formal financial planning according to the study results.

The study established that among the many financial practices involved in businesses, only some were being practised by the SMEs in Nairobi. The results indicated that the SMEs practised periodical budget estimations and did activities based on their budgets. The SMEs also practised some financial analysis especially on calculations of profits and losses after transactions and before making purchases.

However, the study found that the SMEs did not prepare financial statements on a timely and formal ways. Most of the SMEs lacked periodic financial statements and others totally had never drawn financial statements. Also the SMEs practised proforma creation to a less extent. This indicates that costing was not very much done by the SMEs operating in Nairobi City Centre at the time of the study.

Apart from the financial planning activities carried out, the SMEs were found to practise some financial control practices. According to the study results, the SMEs greatly recorded transactions of their businesses and constantly compared costs and selling prices before making purchases to avoid untimely losses. Those SMEs which deal with sale of general retail goods monitored their stock levels over different times.

The study findings indicate that SMEs which did the above mentioned financial related practices at different intervals. The study realised that SMEs did their budgeting on annual basis. The study revealed that those SMEs which drew financial statements and balance sheets were mainly done on yearly basis. The financial analysis and computation of ratios was done also done on annual basis in those SMEs which computed financial ratios and analysed their financial progress.

The above financial planning practices had some impact on the performance of the SMEs. Those SMEs which practised sound planning of their finances achieved a lot in return. The study results shows that planning for the finances helped the enterprises to keep capital of their business and improved the management of the risks of the enterprises. The financial planning also greatly contributed in improving the efficiency of the SMEs and expanded the capacity of the SMEs to embrace opportunities.

Further the effect of the financial planning by the SMEs was evident on their operations and general performance of their operations. The financial planning practises undertaken by the SMEs in Nairobi City Centre greatly contributed towards easing the financial transactions crisis, and having access to credit. The enterprises recorded reduction of losses due to human errors and mishandling, increased efficiency which led to increase in profits.

The financial planning practices also had other benefits such as keeping of clean records. The records served as collaterals for business to secure loans when need arises. Also the financial planning practices acts like a framework which guides the SMEs to work and achieve certain targets within a specified period of time.

5.3 Conclusion

The study concludes that most of the SMEs enterprises in Nairobi City Centre do some financial planning practises. The SMEs however, do not perform all the financial planning activities but do some of them.

The study notes that the most practised financial planning practises by SMEs in Nairobi are periodical budget estimations, activity-based budgeting and financial analysis. This includes computation of financial ratios and comparing their values with other business.

The study notes that some important financial planning practices are not undertaken by the SMEs such as drawing of financial statements on regular basis and proforma creation indicating that costing and cost effectiveness has not been well addressed by the SMEs.

The study reports that SMES operating in Nairobi City Centre perform some monitoring and control activities which include recording of transactions of the businesses, comparing of the costs and selling prices when doing purchases, monitoring of stock levels and management of risks.

The study concludes that the financial planning practices such as budgeting, drawing of financial statements and computing of financial ratios and financial analysis are done on annual basis by most of the Enterprises.

The study notes that financial planning has had positive impacts on the performance of the SMEs.

Firstly the financial planning helped the SMEs to keep capital, manage risks, increased the efficiency of operations and expanded the capacity of the SMEs to embrace opportunities.

Further financial planning has eased financial crisis, made credit accessible, reduced losses caused by human errors, provide collaterals for securing loans and act as a frame work to guide the activities of the businesses.

5.4 Limitations of the study

The study was able to identify five limitations as below:

First, the study collected data from the SMEs which are operating in Nairobi City Centre. The study was limited to SMEs that surviving as at the time of the study thus failed enterprises were not considered. Therefore, it can also be assumed that questionnaires are mainly returned by those enterprises already practising financial planning. Thus the findings might be artificially inflated.

Secondly, the study findings are difficult to compare due to differences in the SMEs in terms of enterprise type, industry or time in operation. Therefore it would be interesting to examine whether there are differences in the degree of financial planning with regard to industry affiliation.

Thirdly, the study analysed the general relationship of the financial planning practices on the financial performance of the SMEs. However, there are other indicators which the study never assessed such as sustainability, expansion, customer retention among others which have to be taken into account while making financial plans.

Fourthly, the study collected data from SMEs. Given that large enterprises work differently, have different practices and use different strategies to increase their market share. The effect of financial planning strategies could be different based on the size of the SME.

Lastly, the time frame of 5 years within which study was based was too short and therefore the results may not be comprehensive and conclusive enough if SMEs that have operated for more than 5 years or less than 5 years were studied.

5.5 Recommendations

5.5.1 Policy recommendations

The study found that some of the SMEs do not practise financial planning in their businesses which renders their business prone to anticipated business risks and some inefficiency. It is recommended that awareness be created by policy makers to the SMEs on the importance of the financial planning in business operations.

The study established that most of the SMEs do not prepare financial statements and less do prepare proforma creation. This has rendered the enterprises unable to determine their progress and also to monitor their cost expenses. It is recommended that SMEs adopt the culture of financial planning to include drawing of financial statements and creation of business proformas.

The study established that SMEs review their financial planning practises on annual basis. This period is long for close monitoring of the businesses and therefore it is difficult to correct deviations at early stages. Thus to deal with problem, it is recommended that reviews be done on biannually basis to reduce the long-time intervals.

The study found that financial planning in most of the SMEs is not automated. This exposes the business to human errors and inaccuracies which would otherwise be corrected using technology. The study recommends use of technology in financial planning so as to ease the processes.

5.5.2 Recommendations for further studies

The study collected data from the SMEs which are operating in Nairobi City Centre. However, the findings on the financial planning practices in Nairobi could be different compared with other regions. Thus a similar study should be undertaken in other regions to get a better understanding of the effect of financial planning and performance of the SMEs.

The study recommends that other similar studies be done on an industry by industry basis so as to compare the effect of financial planning on performance of SMEs.

The study recommends that similar studies be done on the effect of the financial planning practices on other indicators of business performance such as sustainability, expansion, market share and customer retention.

The study recommends that the same kind of study be done on the large enterprises which have different practices and use different strategies to increase their market share and the effect of financial planning strategies could be different from that on the SMEs.

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APPENDICES

Appendix 1: Questionnaire

SECTION A: BACKGROUND INFORMATION

1. Indicate your title in the organization in the space provided

    Business Owner [ ]

    Business Partner [ ]

    Firm manager [ ]

    Financial manager [ ]

2. What is your area of specialization in terms of career choice and training?

    Business [ ]

    Financial Services [ ]

    Engineering (other technical undertakings) [ ]

    Agriculture [ ]

    Research [ ]

    Teaching [ ]

    Others (Specify)...

SECTION B: FINANCIAL PLANNING IN THE FIRM

3. Does your firm undertake any financial planning?

    Yes [ ] No [ ]

4. Indicate the extent to which your firm und retakes the following financial planning activities.

	Very great extent	Great extent	Moderate extent	Less extent	No extent at all
Periodical Budget estimations					
Creation of financial statements					
Business Proforma creation					
Activity based budgeting					
Financial analysis					

5. If YES in any of the issues in (6.) above, who carries out these functions? And explain why?

   ………………………………………………………………………………………………………

   ………………………………………………………………………………………………………

   ……………………

6. Indicate the extent to which you undertake the following business activities.

	Very great extent	Great extent	Moderate extent	Less extent	No extent at all
Recording the transactions of your business					
Comparing cost and selling prices before buying stocks					
Monitoring stock levels					
Setting profit target periodically					

7. What other financial planning functions are carried out within your firm?

....

....

....

8. In your own opinion, to how often are the following financial planning techniques reviewed?

	Monthly	**Quarterly**	**Biannually**	**Annually**	**Biennially**	**Every 2-5 years**	**Never**
Budgeting							
Proforma creation							
Income Statement Creation							
Balance sheet creation							
Financial Analysis							

SECTION C: EFFECTS OF FINANCIAL PLANNING ON PERFORMANCE

9. To what extent does financial planning in your firm affect you in the following firm activities?

	Very great extent	**Great extent**	**Moderate extent**	**Less extent**	**No extent at all**
Capital Availability					
Liquidity of the firm's Assets					
Risk Management					
Efficiency					
Capacity to Attract Capital					
Capacity to Embrace Opportunities					

10. Please briefly explain in what ways these factors are affected by financial planning?... ....

11. In your own opinion, to what extent would you rate the positive influence of financial planning on the following factors of overall firm performance? Rate your response on a five point Likert scale where 5= very great extent, 4= greater extent, 3= moderate extent, 2=little extent, 1=No influence at all

	Very great extent	**Great extent**	**Moderate extent**	**Less extent**	**No extent at all**
Eased financial transactions					

Eased Access to credit					
Minimized cost in auditing					
Minimized loss of cash during handling					
Improved Efficiency the business					
Increased returns through increased efficiency					
Increased ability to attract shareholders					

12. Please, briefly explain how planning practices affect your financial performance...
....
....
....

THANK YOU FOR YOUR PARTICIPATION

Appendix 2: List of SMEs

1. Alihito Agency
2. Alliance Trading Co
3. Amana Capital Ltd
4. Anish Wholesalers
5. Apex Lifestyle Consulting
6. Aragon Trade Office (K) Ltd
7. Beauty Wholesale K Limited
8. Bethlehem Trading Co (E A) Ltd
9. Biashara Africa Limited
10. Brisk Trading
11. Bunny Wholesalers Ltd
12. Camac (K) Ltd
13. Cape Equatorial Group Of Co
14. Central Wholesalers
15. Chamunda Wholesalers (K) Ltd
16. Colorado Trading Co
17. Colorado Trading Co
18. Commodity Fields International, Llc
19. Crony Trading Ltd
20. Deluxe Fruits Ltd
21. Deluxe Trading Company
22. Dhamana Enterprise Ltd
23. Dharani Wholesalers
24. Dipi Wholesalers Ltd
25. Enigma Trading
26. Fatuma Wholesalers
27. Fedha Wholesaler
28. Futuresoft Technologies
29. Gathiga General Store
30. Gigiri Forex Bureau
31. Good Enterprises Ltd
32. Good Morning Wholesalers

33. Hamesh Enterprises Co
34. Hungkar Trading
35. Hurligham Forex Bureau Ltd
36. Inner Resources Ltd
37. Jash Agencies Ltd
38. Jay Emporium Ltd
39. Jirimu Agencies
40. Kayvee Agencies
41. Kebimex Company Ltd
42. Kenza Exchange Bureau Ltd
43. Khursraj Enterprises Ltd
44. Kiran M Shah & Co
45. Kiutha Trading Co Ltd
46. Leading Edge Food & Enterprises Ltd
47. Maki Investments
48. Marubeni Corporation
49. Mawadi Equipment Supplies Ltd
50. Mbele Kabisa Co Ltd
51. Munir Wholesellers
52. Music House Ltd
53. Nairobi Bureau De Change Ltd
54. Nawal Investments Ltd
55. Ngara Road Self Service Store
56. Nikohapa Ventures Ltd
57. Nyaira Wholesalers
58. Pinnacle Forex Bureau Ltd
59. Pumwani Industry Enterprises
60. Ramesh Enterprises
61. Real Value Forex Bureau Ltd
62. Recours Four Kenya Consultants
63. Renhe Trading Co Ltd
64. Ruiria Investments Co Ltd
65. Rungu Distributors Co Ltd
66. Rurigi Enterprises
67. Rurigi Enterprises Ltd

68. Sanlese Trading Co
69. Sawamu Enterprises
70. Sme Kenya
71. Sunflower Trading Ltd
72. Sunshine Forex Bureau Ltd
73. Supernatural Trading Co Ltd
74. Tentel Trade & Supplies Ltd
75. Three Stars Foreign Exchange Bureau Ltd
76. Trans Asia Trading Co Ltd
77. Urban Properties Consultants & Developers Ltd
78. Viazi Wholesalers
79. Village Market Forex Bureau, The
80. Vima Agencies
81. Virani Curry Powder & Flour Mills
82. Waleed Electronics
83. Wamwa Provision Store
84. Welcome Wholesalers
85. Yaya Centre Exchange Bureau Ltd
86. Yusufali Enterprises
87. Freyr International Limited
88. Apex Lifestyle Consulting
89. Amana Capital Ltd
90. Crony Trading Ltd
91. Catholic Lay Missionaries
92. Al-Mustaqim Trading Co (K) Ltd
93. Integrity Company Ltd
94. Ap Enterprises
95. Dahabshill Forex Bureau Ltd
96. Lakhmidass & Sons (K) Ltd
97. Southlink Trading Co Ltd
98. Winfield Trading Co Ltd
99. Addani General Trading Co