

**THE EFFECTS OF BENCHMARKING PRACTICES ON FINANCIAL
PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KENYA**

BY
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DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to the University of Nairobi or any other college for academic credit.

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DECLARATION BY SUPERVISOR:

This research paper has been submitted for examination with my approval as university supervisor.

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DEDICATION

To my Parents, and only sister for your unfailing love and care during this long journey in search for knowledge.

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LIST OF ABBREVIATIONS

CI	Continuous Improvement
GoK	Government of Kenya
KEBS	Kenya Bureau of Standards
KPIs	Key Performance Indicators
PM	Performance Measurement
PMS	Performance Measurement Systems
SME	Small and Medium Enterprises
TPM	Total Productive Maintenance
TQM	Total Quality Management
OOE	Overall Operational effectiveness

ABSTRACT

The purpose of the study was to establish the effects of benchmarking practices on the financial performance of SME's in Kenya, the study was also done to find out the new business practices adopted by the SME's as a result of benchmarking practices to improve their financial performance. A sample size of 56 SME's was used in the study which was collected using a random sampling method, there were 31 respondents whose data was analyzed to come up with the findings. The research used a casual research design collecting both Primary and Secondary data. The data was collected using self-administered questionnaires issued to the respondents which was dropped and picked later at the selected employees` desks and was analyzed with the help of SPSS. The study findings reveal a positive and significant relationship between benchmarking practices adopted by SME's and the financial performance. The study further shows that benchmarking enhance the overall business performance realized by the SME's by helping to change business and management practices which were not value adding. Two questions were tested as determine the level of significance which are whether there exists a relationship between benchmarking practices adopted by SME's and financial performance improvement and how strong the relationship is, the study found out that there exists a relationship and most of the SME's that carry out benchmarking practices and adopt the practices had a positive change in their financial performance. The SME's should have their own policy which facilitates a body which allows access to finances to SME's only to facilitate training on better business practices to improve financial performance.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

In an aim to identify more efficient ways of performing activities and business operational processes, SMEs are giving more attention to benchmarking. Benchmarking involves comparing key activities with world class best practices. It attempts to identify an activity, such as customer order processing, that needs to be improved and finding a non-rival organization that is considered to represent world class best practice for the activity and studying how it performs the activity (Drury 2009).

Most of the SMEs have simple systems and procedures to enhance flexibility, decisions making in short times, greater understanding and quick response to consumers needs. Although, SMEs have more pressure to keep their competitiveness level, both in the national and international market (Singh et al., 2008). However, according to (Chiarvesio. 2004), SMEs are characterized by a dynamic behavior in terms of innovation, relationships management with market and suppliers, internationalization processes and their ability to organize and manage business agreements; which means better performance and competitiveness level (Leachman 2005), if this is considered a synonym of productivity, assuming quality and efficiency in these variables

Nowadays, innovation initiatives in SMEs are very important for them to become more competitive. Small and Medium-sized enterprises (SMEs), and especially, technology-based ones tend to have better control of their R&D activities through Innovation Management efforts. In this sense, the first step in order to start Innovation Management

initiatives is to diagnose the current company's situation and to compare it with other companies in the same market. Therefore, increasing market competition has led for increased innovation programmes and initiatives (McAdam & Keogh, 2004) for an effective economic and social development. In developing countries especially, the need for a solid and reliable base on knowledge management and innovation management is vital for the development of SMEs initiatives and practices to succeed.

All operations, no matter how well managed, are capable of improvement. In fact, in recent years the emphasis has shifted remarkably towards making improvement on the main responsibilities of operations managers of SMEs. Before operations managers can devise their approach to the improvement of their operations, they need to know how good they are already. The urgency, direction and priorities of improvement will be determined partly by whether the current performance of an operation is judged to be good, bad or indifferent. All operations therefore need some kind of performance standard as a prerequisite of improvement. At its simplest competitive performance standard would consist merely of judging whether the achieved performance of an operation is better than, the same, or worse than that of its competitors (Norman 2001).

1.1.1 Benchmarking Practices

Benchmarking is an activity adopted by corporations to improve their performance, and is a strategy for organizational learning and adjustment. It allows the firm to compare its operational and managerial practices and performance to those of its competitors, or to those of firms which are considered world-class enterprises or the best in their industry in order to achieve continuous improvement.

Information about practices or performance obtained for other firms is thus useful in developing the benchmarking firm's operational and managerial practices.

It is a continuous process and provides a useful tool for allowing a firm to compare its performance, relative to an average or to other firms. Benchmarking leads to better understanding of the SMEs current practices and makes use of systematic comparison of practices and performance with those of others, in order to develop improvement actions, which will bring performance levels up to, or beyond, those of the 'best in class'. Given the importance of SMEs innovativeness for long-term growth, benchmarks should be used for assessing SMEs innovativeness in terms of the required activities for companies to innovate in practice (Guimaraes and Langley 1994).

According to Min, Min and Chung (2002), benchmarking is a continuous quality improvement process by which an SME can assesses its internal strengths and weaknesses; evaluates comparative advantages of leading competitors; identifies best practices of industry functional leaders; and incorporates these findings into a strategic action plan geared to gaining a position of superiority. It is a process of identifying, sharing and using knowledge and best practices by measuring against defined standards or benchmarks. In other words, it involves continuously monitoring the value customers put on the company's product and comparing it with the best.

Benchmarking has been used as a tool, a methodology and a technique for continuous improvement in sectorial operations to gain and maintain competitive advantage. Participating on benchmarking has promoted a culture of thinking about quality, assessing one's own performance and taking responsibility for it. This is aimed at

improving customer relations and promoting self-criticism. SMEs may adopt various types of benchmarking practices depending on the area they wish to improve the types of benchmarking may include Process benchmarking: The SMEs focus their observation and investigation of business processes with a goal of identifying and observing the best practices from one or more benchmark firms. Activity analysis is required where the objective is to benchmark cost and efficiency; increasingly applied to back-office processes where outsourcing may be a consideration (Watson, 1992). Dimensions typically measured are quality, time, and cost. Improvements from learning mean doing things better, faster, and cheaper.

Product benchmarking: SMEs try to find out what products are being offered by the others and make comparisons in terms of their costs, turnover and loans default rate. This process can sometimes involve reverse engineering which is taking some of competitor's products to find strengths and weaknesses. This leads to designing new services and products or upgrading the current ones. Financial benchmarking: This refers to the process by which a firm performs a financial analysis and compares the results in an effort to assess its overall competitiveness and productivity. It's measured by return on investment, return on capital and liquidity (Watson, 1993). Operational benchmarking: This embraces everything from staffing and productivity to office flow and analysis of procedures performed. It is indicated by: The number of customers a member of staff can serve in a day; Ratio of staff to membership and members' withdrawal rate.

Strategic benchmarking: This refers to proactive analysis of emerging trends, options in markets, processes, technology and distribution that could affect strategic direction and

deployment. In SMESS, this involves observing how others compete and is indicated by the extent to which a SMES compares its strategies to those of top performers in the industry with the intention of adopting the best strategic practices.

1.1.2 Financial Performance

Financial and operational constraints have been suggested to be one of the most important barriers to growth (Storey 1994). It has also been suggested, that especially SME's face the most difficulties in achieving their financial and operational objectives, it is for this reason most of them are turning their attention to benchmarking so as to be financially stable and independent in recent studies it has been identified that SME's turn to use of external financing to finance their daily operations especially with use of overdrafts from banks which at times hinders their operations according to the SMEs financial monitor 39% of SMEs used external finance in 2014, in line with most of 2013 but somewhat lower than the equivalent quarter of 2012 (43%). Smaller SMEs remained less likely to be using external finance (35% of those with 0 employees to 64% of those with 50-249 employees). There has though been a long term decline in the use of finance amongst SMEs with employees (since Q2 2012 the proportion of the largest SMEs with 50-249 employees using external finance has fallen from 78% to 64%).

1.1.3 Relationship between Benchmarking Practices and Financial Performance

Benchmarking compares SME's business processes and financial performance metrics to industry bests or best practices from other companies, the main financial data that is of concern is the gross revenue, profitability, the return on equity, and operational data that is of concern is cost per unit of measure, productivity per unit of measure, cycle time of

x per unit of measure or defects per unit of measure quality, time and total cost of operations.

SMEs management identifies the best firms in their industry or in another industry where similar processes exist, and compares the results and processes of those studied to one's own results and processes. In this way, they learn how well the targets firms perform and, more importantly, the business processes that explain why these firms are successful.

1.1.4 Small and Medium Size Enterprises in Kenya

SMEs are defined as businesses operating in both the informal and formal sectors of the economy and employing between 5 and less than 20 employees (GOK, 2005).

Stevenson et al. (2005), defined SMEs in terms of the “very-small” enterprises with 6-10 employees operating “in-the-open” and the “small-scale” enterprises with 11-50 employees operating from legitimate business premises.

Small and Medium sized Enterprises in all economies have been identified as primary agents for job creation. They strengthen the capacity of a country to generate employment and wealth for the general benefit of national and regional economies. They are highly important in the promotion of national and regional economic development. However, almost 50% of these companies cease operation within five years of their creation, which raises concerns that they consistently underperform and so are ill prepared for future challenges this paper hence will also determine the extent to which the benchmarking practices will aid in curbing this challenges.

Small and Micro Enterprises (SMEs) play an important economic role in many countries. In Kenya, for example the SME sector contributed over 50percent of new jobs created in 2005 but despite their significance, SMEs are faced with the threat of failure with past statistics indicating that three out five fail within the first few months. This study sought to understand how SMEs manage the challenges they face by use of benchmarking practices to improve their financial performance. These challenges seem to change (evolve) according to different macro and micro conditions. This study employed stratified random sampling to collect data from 15 businesses using interviews and questionnaires. The data was analysed descriptively and presented through figures, tables and percentages. The findings indicate that SMEs face the following challenges; competition among themselves and from large firms, lack of access to credit, cheap imports, insecurity and debt collection. Credit constraint seems to be easing up when compared to previous researches. Relevant training or education is positively related to business success. The SMEs have the following strategies to overcome the challenges; fair pricing, discounts and special offers, offering a variety of services and products, superior customer service and continuously improving quality of service delivery.

1.2 Research Problem

SMEs in Kenya are continuously increasing and their role in economic development has been noted over the decades. SMEs create employment in their industry and provide meaningful competition in goods and service delivery in the industry.

Over the years the market opportunities of SMEs in terms of flexibility and proximity to their markets are no longer sufficient to ensure their competitiveness in the new global

economy (Skandalakis and Nelder, 2001), the adoption of new business practices by these organizations must be facilitated, practices whose identification will be made through a benchmarking exercise (Cagliano et al., 2001). Noting this, Cassell et al. (2001) emphasize that benchmarking activities developed for organizations must be specific to the environment and constraints of these organizations if the implementation of the practices identified by such activities is to succeed and result in increased performance. Distinct strategic objectives, greater environmental uncertainty and limited resources are some of the aspects that would require the development of benchmarking practices that are specific to SMEs if these practices are to be adopted effectively.

Global Studies done on benchmarking by SMEs done in both small and large organizations show that the implementation of certain practices found in business excellence models has had satisfactory outcomes in operational and financial terms (Oakland, 1999). Husband and Mandal (1999) also identify the uniqueness of an SME's manufacturing operations as being a limiting factor to quality enhancement implementation and provide a series of dimensions that are unique to SMEs. Deleryd et al. (1999) identify that SMEs need to make decisions and improve their processes based on accurate and timely information relating to the performance of their manufacturing process. Organizations do not become world class overnight. It is a slow and deliberate process of setting targets and working towards achieving them (Lema and Price, 1995). This is where benchmarking plays a crucial role in class parameters that deliver world class performances (Roider, 2000). Lapre´ and Van Wassenhove (2002) performed an extensive study of a European manufacturer and found that both the 10 operational and

conceptual learning are important for knowledge transferability, and consequently, for both productivity and “bottom line” improvement.

Locally many studies have been done on benchmarking. Amolo (2002) studied benchmarking the order delivery process for continuous improvement the case of the Kenyan oil industry, Gitonga (2005) conducted a survey of improvements through benchmarking in the Kenyan construction firms, Namu (2006) researched on benchmarking as a performance improvement tool the case of KPLC, Litunya Ambula (2006) evaluated benchmarking & performance in public secondary schools in Nairobi Province, Magutu (2006) conducted a survey of benchmarking practices in higher education in Kenya the case of public universities, Kombo (2007) did a survey of the extent of implementation of benchmarking practices in the manufacturing sector in Kenya while Victor Tuitoek (2007) studied benchmarking health, safety & environmental performance measurement practices in the oil industry in Kenya.

This study seeks to find out whether benchmarking practices of SME’s affect their financial performance.

1.3 Objectives of the Study

To determine the relationship between benchmarking practices and financial and performance of SME’s in Kenya

1.4 Value of the Study

During last decades, many SME’s financial and operational procedures have been developed. However, most of the SME’s continuously are faced with rapid changes in

technological improvements to enhance efficiency. This study identifies how the SME's benchmark this procedures for successful firms and the effective use by the SME's.

To the SMEs, the study will identify the challenges that are faced in implementation of business process improvement approaches by the SME in Kenya. This can in turn facilitate informed industry interventions to resolve the challenges identified.

To the SMEs, the study will identify the challenges that are faced in implementation of business process improvement approaches by the SME in Kenya. This can in turn facilitate informed industry interventions to resolve the challenges identified. The results of the study will also be useful to the government in formulating policies and developing regulatory frameworks for manufacturing SMEs, especially where quality standardization is concerned. Additionally, the study will benefit the academia as it will add to the literature on business process improvement and identify areas for further study.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

In this chapter the different barriers that have been identified in previous studies will be presented, both the theoretical and empirical literature which covers an overview of Process improvement among SMEs, and the approaches used ie six sigma and benchmarking. The specific areas covered here are benchmarking, benchmarking process, benchmarking tools, application of benchmarking in various areas of SME businesses, advantages of benchmarking and relationship between benchmarking and performance.

2.2 Theoretical Review

Contingency theory has been widely used in researches on measuring the performance and effectiveness of an organization and it claims that there is no optimum method to systematize a firm and the organization structure of the company (Fiedler, 1964). In other words, contingency theory argues that the most appropriate structure for an organization is the one that best fits a given operating contingency, such as technology (Woodward, 1965; Perrow, 1970) or environment (Burns & Stalker, 1961; Lawrence & Lorsch, 1967). As every company faces its own set of internal and external constraints as well as special environmental incidents that effect in distinctive levels of environmental uncertainties, there is no one optimal organization design for every company because every company has different organizational culture and different perspective towards risk.

Benchmarking is recognized as an essential tool for continuous improvement of quality. A large number of publications by various authors reflect the interest in this technique. Reviews of literature on benchmarking have been done in the past by a few authors.

However, considering the contributions in the recent times; a comprehensive review is attempted here. Originally, the term, 'benchmark' derives from land surveying where a mark, cut in the rock, would act a reference point. In the business world, a benchmark is a standard of excellence against which to measure and compare (slack, 1998).

In 1979, the Xerox corporation, the document and copying company; used the term 'competitive benchmarking' to describe a process used by the manufacturing function to revitalize itself by comparing the features ,assemblies and components of its products with those of competitors. However, since then the term Benchmarking has widened its meaning to cover service organizations.

American production and quality centre (1997)defines benchmarking as the process of performance improvement by continuously identifying, understanding and adapting outstanding practices and processes found inside and outside the organization and implementing the results.

This definition captures the essence of benchmarking, namely learning from others. The core of the current interpretation of benchmarking is the measurement of own and benchmarking partner's performance level both for comparison and for registering improvements in your own organization and improvement which is the ultimate objective of any benchmarking study. Benchmarking is thus, the process continuously measuring and comparing one's business processes against comparable processes in leading organizations to obtain information that will help the organization identify and implement improvements(Andresen and Petersen,1995).

2.2.1 Resource Dependence Theory

Resource Dependence Theory (RDT) is the study of how the external resources of an organization affect the behavior of the firm. The procurement of external resources is an important tenet of both the strategic and tactical management of any company.

Nevertheless, a theory of the consequences of this importance was not formalized until the 1970s, with the publication of *The External Control of Organizations: A Resource Dependence Perspective* (Pfeffer and Salancik 1978). Resource Dependence Theory has implications regarding the optimal divisional structure of organizations, recruitment of board members and employees, production strategies, contract structure, external organizational links, and many other aspects of organizational strategy. Resource Dependence Theory is one of many theories of organizational studies regarding the behavior of organizations. In many ways, the predictions of Resource Dependence Theory are similar to those of transaction cost economics, but it also shares some aspects with institutional theory.

2.2.2 Selection Psychology Theory

Past behavior and performance is considered to be the best predictor of future financial performance according to the theory of selection psychology (Ling, 2000). Hogan et al.'s recent meta-analytic research suggests that performance in many jobs should, in principle, be predictable using good measures of past behavior and performance, including “being responsive to client's needs”, “being persistent” and “taking initiatives”. Many studies show that past performance is an important selection criterion for

construction consultants (Winch and Schneider, 1993), particularly when projects are of a complex nature.

2.2.3 Information Theory

Companies may seek to communicate their environmental performance to outside stakeholders, but may not always find this easy to do since they may lack full knowledge of the products, processes and materials flowing through their supply chains. Typically, suppliers may hold more information about their environmental performance and the performance impact is to be experienced by the customers. This situation is defined as information asymmetry. A major advantage of greening supply chains is derived from the capability to market and sell green products. Such capability potentially develops new products and hence builds competitive advantages for enterprises. Yet, companies may not be able to reap this image benefit due to the information asymmetry arising from consumers' inability to discern how green the products or materials from the supply chain are (Delmas and Montiel, 2009).

2.3 Determinants of Financial and Operational Performance in SME's

2.3.1 Profitability

Pecking order theory suggests that a firm will tap into internal funding first, whereas trade-off theory supposes that a profitable firm gives more ground to the use of tax shields. Profitability is then a key benchmark for a SME' performance, thus helping in improved acceptance of finance applications.

2.3.2 Age

Firm age largely corresponds to the business cycle of SMEs. Start-up and early-stage SMEs may then resort to external equity, particularly private investors and business angels (Berger and Udell, 1998). One reason is the restrictions in internal equity. At the starting stage of a SME, retained profits are scarce, and the personal sources of the owner and firm-connections are very limited. A second reason is associated with a combination of information asymmetries and potential agency problems related to the lack of a trading history. The lack of collateral sable assets can exacerbate the problem of restricted access to finance (Bhaired and Lucey, 2010). From this perspective, firm age positively relates to external finance seeking. However, as SMEs move from the start-up or early-stage to the middle-stage, they can source more finance from retained profits. SMEs can then replace external equity with internal equity.

2.3.3 Innovation and Growth Opportunities

Innovation is the process of the adoption of internally or externally generated devices, systems, policies, programs, processes, products or services that are new to the adopting organization and it can be treated as a proxy for growth opportunities (Rosenbusch et al., 2010). The influence of innovation or growth opportunities on SME's finance decision-making has been widely discussed. This reveals that by reducing debt and external borrowing, SME's with growth opportunities may avoid the shareholder-creditor conflict in which the benefits can transferred from shareholders to creditors (Myers, 1977; Jensen and Meckling, 1976).

Moreover, debt can act as a mechanism to alleviate agency cost by disciplining managers (Jensen, 1986). Therefore, a firm with growth opportunities may need less debt (Fama and French, 2002). However, given the assumption that SMEs face financing constraints, those with growth opportunities are more likely to exhaust internal funds and require additional funds. In combination with the traditional concern of SMEs with control and independence, SMEs with growth opportunities may seek external debt instead of external equity. As a result, the influence of growth opportunities on SMEs finance seeking can be either negative (Heyman et al., 2008; Lopez-Gracia and Sogorb-Mira, 2008), positive (Degryse et al., 2010; Riding et al., 2010), or insignificant (Psillaki and Daskakis, 2009)

2.4 Empirical Literature Review

Several studies have been conducted on the application of PI techniques for quality management in both small and large enterprises. It is obvious that these techniques have contributed immensely to productivity improvement, quality of products and services in large industries; but of little application in SMEs. Gunasegaram (2000) supported the claim that the implementation of these manufacturing approaches has not received due attention from SMEs. 26 Some studies (Brown and Van der Weile, 1995; Husband, 1997; Husband and Mandal, 1999; Yusof and Aspinwall, 1999; Andrews, 2004) have indicated low application of these techniques among SMEs.

There are several reasons for the relatively low application of statistical methods in SMEs. Management in small companies, in general, do not have the sufficient theoretical knowledge to see the potential of using statistical tools. In many cases they, and their

employees, even become frightened when statistical tools are discussed. Small companies also lack resources in the form of time and personnel. These organizations tend to have a lean organization and therefore they find it difficult to appoint a facilitator or co-ordinator for the implementation process. In addition, they also have limited resources to provide internal training. Lack of resources in these aspects leads to a need for a careful analysis of which strategy to use when implementing statistical methods in order to succeed (Six Sigma Qualtec, 2002).

A review of Lean manufacturing indicate that it encompasses a wide range of management practices, including just-in-time, quality systems, work teams, supplier management, value stream mapping, 5s, SMED, etc in an integrated system. Etkin et al. (1990) found that most small enterprises who claimed to be using lean manufacturing actually did not adopt some of the major components of lean management system while Brown & Inman (1993) identified lack of top management commitment, investment in specialized equipment, education, training and limited financial resources as reasons for SMEs not adopting the lean system. Furthermore, the need for continual improvement and methods involved in implementing Lean manufacturing require that the area needing improvement be selected followed by developing a theoretical framework which creates an understanding of the lean philosophy. 27

However, Gunasekaran et al. (2000) contends that the manufacturing practices used to achieve excellence in large-scale industries can be successfully implemented in SMEs for quality and productivity improvement. However, despite all the known contradiction and limitation faced by SMEs, Yeb-Yun Lin (1999) believed that a team oriented tool and

method can be successful in a small company. Nelder & Willcock (2000) further stressed that most SMEs usually consider opportunity that offer instant remedy to a wide range of problems. This means that small enterprises are known to prefer short-term goals, benefits and strategy. These features of SMEs make the sector an ideal target for improvement opportunities in business, production, and cooperation with large and other smaller enterprises.

2.5 Summary of Literature Review

In the literature review benchmarking is applied in some context in the evaluation of competitive benchmarking various countries by the SMEs. The findings reveal that the factors affecting implementation of benchmarking constitute the process metrics that are comparable across business SMEs. They form a credible process for benchmarking activities that are applicable to most business activities, to increase the efficiency.

This implies that the same can be applied to benchmarking activities in any SME in Kenya. However, it is difficult to predict which type of benchmarking can be applied, or is being applied in Kenyan SMEs.

Benchmarking requires bringing conventional benchmarking and new views on benchmarking much closer. Benchmarking should reflect a type of culture where change is central, rather than merely achieving pre-determined goals at higher level of policy. Benchmarking should constitute a tool for regularly improving and revising the goals and practices of innovation internal to the system. Although innovation systems are internationally, the assessment of the innovation system needs to combine comparisons to external actors, but also introspective exercises of self-comparison.

There is a consensus among the authors on the different types of benchmarking that can be applied, the major ones being internal, competitive, functional, and process benchmarking. The last three can be easily applied by all types of organizations since the organization is always comparing itself against some external entity. On the other hand, internal benchmarking depends on the size of the organization; it must be large enough with many departments or have several units in different geographical locations to compare against each other.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter sets out various stages and phases that were followed in completing the study. It will involve a blueprint for the collection, measurement and analysis of data. In this stage, most decisions about how research was executed and how respondents were approached, as well as when, where and how the research was completed are explained. Therefore in this section, the research will identify the procedures and techniques that were used in the collection, processing and analysis of data. Specifically the subsections included are; research design, target population, description of research instruments, sampling design, data collection instruments, data collection procedures and finally data analysis.

3.2 Research Design

Descriptive research design was adopted for the study. According to Donald and Pamela (2006), a descriptive study deals with the what, how and who of a phenomenon which is the concern for this study. This research design is therefore appropriate for this study since the objective is to examine the effects of benchmarking on the financial performance of SMEs in Kenya.

3.3 Population

The population of the study consisted of SMEs in Kenya. It also contains nearly all types of SMEs companies which are represented in the stated population. The unit of study was SMEs and the respondents will be the various SMEs employees from different industries depending also on number of years they have been operating. The Population of 205

SMEs in the Industrial sourced from KEBS will be chosen and a sample of 56 SMEs was sampled.

3.4 Sample

The study was conducted from SMEs in Kenya and a stratified random sampling technique was employed to select respondents. A random sample of 56 SMEs was drawn. This sample will represent 27% of the target population. Follow-up phone reminders were also made to each non-responding firm in an attempt to increase the response rate from the sample.

3.5 Data Collection

The study used both primary and secondary data. Secondary data was derived from management reports and Annual General Meeting reports, management books and research reports. The primary data was collected through the use of a structured questionnaire which were dropped and picked later at the selected employees` desks. The respondents were assured about confidentiality of their feedback.

The questionnaire consisted of both open and closed ended questions. Interviewing method was also be used in the data collections, this method was more appropriate to elaborate some of the questions that arise through the study. It was also used as a primary insight for the questions that we couldn't get through the questionnaires.

3.6 Data Analysis and Presentation

After data collection procedure, descriptive statistics was used to analyze the data. According to Mugenda, (2003) use of descriptive statistics enables meaningful

description of scores or measures using indices or statistics data collected was analyzed using graphs, bar charts and pie charts.

Completed questionnaires were edited for completeness and consistency. The data was then coded and checked for errors and omissions and then analyzed using procedures with Statistical Packages for Social Sciences (SPSS), to come up with regression model and use of hypothesis testing analysis. The data was then interpreted in relation to the research objectives guiding the study. The conclusions and recommendations were derived from the findings of the study. The model used was

$$\ln \text{ PROF} = \beta_0 + \beta_1 \text{PBP} + \beta_2 \text{PrBP} + \beta_3 \text{FBP} + \beta_4 \text{SBP} + \beta_5 \text{OBP} + \epsilon_{it}$$

Whereby β_0 is constant of the model while β_1 , β_2 , β_3 and β_4 are the coefficients of the independent variables

$\ln \text{ PROF}$ = natural logarithm of the previous year's profit

PBP = total mean scores for the factors within the Process benchmarking perspective

PrBP = total mean scores for the factors within the Product benchmarking perspective

FBP = total mean scores for the factors within the Financial benchmarking perspective

SBP = total mean scores for the factors within the Strategic benchmarking perspective

OBP = total mean scores for the factors within the Operational benchmarking perspective

ϵ_{it} = an error term for the model

H_0 : there is no relationship between benchmarking and financial performance of SME's

H_a : there exists a positive relationship between benchmarking and financial performance of SME's

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The chapter presents the data gathered from the field and the result of data analysis performed on the data. It also discusses the result obtained relating it to literature that exist in the area, and recommendation are made to industry players based on the findings. Included on the list of information and data generated are frequency tables representing the distribution of responses to each of the questions contained in the research questionnaire.

There were 61 respondents to whom the questionnaires were administered, only thirty-one (31) respondents in the SME's responded which gave a response rate of 52% which was substantial for the data analysis.

4.2 Response Rate

Table 4.2.1 Gender of the Respondents

	Frequency	Percent
Male	18	58%
Female	13	42%
Total	31	100.0

(Source: Research Findings)

The findings in the above table show the gender of the respondents. From the findings, the study established that the majority of respondents were male as shown by 58%, while females were 42%.

Table 4.2.2 Age bracket of the respondent.

Age Bracket	Frequency	Percent
18-28 years	2	6
29 – 38 years	7	22
39 – 48 Years	10	32
49 and above	12	38
Total	31	100

(Source: Research Findings)

On the age of the respondents, the study found that the majority of the respondents were above 49 years as shown by 38%, 32% were 39-48 years, 22% of the respondents were 29-38years 6% were the lowest between 18-28% years,

Table 4.2.3 Level of Education

	Frequency	Percent
Certificate/diploma	8	25
Graduate	13	42
Postgraduate	10	33
Total	31	100.0

(Source: Research Findings)

According to the findings, the majority of respondents had an undergraduate degree as shown by 42% of the respondents, 33% had a postgraduate degree, while a small proportion of respondents as indicated by 25% had a certificate/diploma as their highest level of education.

Table 4.2.4 Position held in the organization

	Frequency	Percent
Head of department	10	33
Assistant manager	12	39
Supervisor	9	28
Total	31	100.0

The study also sought to establish the positions that the respondents held in their organizations. From the findings, the respondents who held positions such as head of department were represented by 33% while 39% of the respondents were assistant managers, and supervisors were represented by 28%.

4.3 Data Validity

Validity is the degree by which the sample of test items represents the content the test is designed to measure. Content validity which was employed by this study is a measure of the degree to which data collected using a particular instrument represented a specific domain or content of a particular concept. Mugenda and Mugenda (1999) contend that the usual procedure in assessing the content validity of a measure is to use a professional or expert in a particular field.

To establish the validity of the research instrument the researcher sought opinions of experts in the field of study especially the researcher's supervisor and lecturers in the department of educational administration, planning and curriculum development. This facilitated the necessary revision and modification of the research instrument thereby enhancing validity

4.4 Descriptive Statistics

According to the findings from the research on the extent that various benefits of Benchmarking enhance the overall business performance realized by a SME', the majority of respondents indicated that it helps to change internal paradigms and "see out of the box" to a very great extent shown by a mean score of 1.4029. Majority of the respondents also indicated that the benefits that enhance overall performance to a great extent were such as it creates awareness of industry good practices and supports the quest for a competitive position shown by a mean score of 2.0000 in each case, determines authentic measures of productivity and enhance high payoff in terms of quality and customer satisfaction shown by a mean score of 2.1429, provides an insight into prevailing business performance shown by a mean score of 2.2857 and helps in the implementation of change shown by a mean score of 2.4286. Further, majority of the respondents also indicated that the benefits that enhance overall performance to a moderate extent were such as team building shown by a mean score of 2.571, organizational development shown by a mean score of 2.5714 and establishes pragmatic goals based on a concerted view of external conditions shown by a mean score of 2.8571. The respondents were also requested to indicate the extent that benchmarking help in improving the various financial performance measures of profitability at the SME's.

According to the findings, the majority of respondents indicated that it improves revenue growth to a very great extent shown by a mean score of 1.3460, and also operating profit margin shown by a mean score of 1.4210. Majority of the respondents also indicated that the financial performance measures of profitability at the SME's that are improved to a great extent were such as net profit margin and net firm income from operations shown by a mean score of 2.0000, operating margin and rate of return on equity shown by a mean score of 2.2857 and gross profit margin shown by a mean score of 2.429. Further majority of the respondents indicated that the financial performance measures of profitability at the SME's that are improved to a moderate extent were such as return on capital employed (ROCE) and rate of return on assets shown by a mean score of

4.5 Correlation Analysis

The study used correlations analysis to find out whether characteristic of SMEs, management and know-how, products and services, the way of doing business and cooperation, resources and finance, strategy, external environment and business success are correlated to benchmarking. Results show that all factors are correlated at 5% significance level.

Correlation analysis also provided answers to three basic questions about the two variables in a the research. First whether there is any relationship between two variables and if so, what is the direction of relationship and subsequently, the magnitude of the relationship from the table in the appendix it can be seen that there is positive relationship with a strong magnitude between financial performance and benchmarking.

Table 4.2.5: Results of correlation analysis

	SMEs characteristics	Management and know-how	Product and services	Customer and market	The way of doing business & co-operation	Resource and finance	Strategy	External environment	Business success
SME characteristics									
Management and know how	.624**								
Product and services	.426** .000 .143	.548** .000 143							
Customer and market	.576** .000 143	.646** .000 143	.664** .000 143						
The way of doing business & cooperation	.501** .000 143	.625** .000 143	.469** .000 143	.569** .000 143					
Resource and finance	.437 .000 143	.498** .000 143	.395** 143	.565** .000 143	.553* .000 143				
Strategy	.589 .000 143	.644* .000 143	.386** .000 143	.516** .000 143	.673** .000 143	.540** .000 143			
External environment	.499 .000 143	.465** .000 143	.496** .000 143	.490** .000 143	.549** .000 143	.689** .000 143	.589** .000 143		
Business success	.547** .000 143	.488** .000 143	.458** .000 143	.573** .000 143	.531** .000 143	.409** .000 143	.469** .000 143	.607** .000 143	

4.6 Regression Analysis and Hypothesis Testing

Table 4.2.6 Regression Analysis

Model		Coefficients	
		Beta	Std.
1	(Constant)	1.334	.311
	Process benchmarking	-.144	.164
	Product benchmarking	0.0196	0.0481
	Financial benchmarking	0.1981	0.0714
	Strategic benchmarking	0.0288	0.0501
	Operational benchmarking	0.0189	0.0399

(Source: Research Findings)

Dependent Variable: process benchmarking, product benchmarking, financial benchmarking, strategic benchmarking and operational benchmarking

The researcher conducted a multiple regression analysis so as to determine the relationship between the SME' performance and the five benchmarking practices. The regression equation ($Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4$) will be:

$$Y = 1.334 + 0.144 X_1 + 0.0196X_2 + 0.1981X_3 + 0.0288\beta_4X_4$$

Whereby $Y = \text{SME}'\text{'s performance}$

$X_1 = \text{process benchmarking}$ $X_2 = \text{product benchmarking}$ $X_3 = \text{financial benchmarking}$

$X_4 = \text{strategic benchmarking}$

$X_5 = \text{operational benchmarking}$

According to the regression equation established, taking all factors (process benchmarking, product benchmarking, financial benchmarking, strategic benchmarking and operational benchmarking) constant at zero, the performance of the SME's as a result of benchmarking practices will be 1.334.

Table 4.2.7 Coefficient of Determination (R²)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.742(a)	.194	.172	.46316

(Source: Research Findings)

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (performance) that is explained by all the five independent variables (process benchmarking, product benchmarking, financial benchmarking, strategic benchmarking and operational benchmarking).

The five independent variables that were studied, explain only 19.4% of the SME'S performance as represented by the R². This therefore means the four independent variables only contribute about 19.4% to the SME'S performance while other factors not studied in this research contributes 80.6% of the SME'S performance.

4.7 Discussion of the Research Findings

The study wanted to establish the level of agreement with the various statements that relate to the relationship between benchmarking and performance. From the findings, majority of the respondents strongly agreed that benchmarking was effective though is not sufficient the SME' also needs vision, energy and teamwork to increase its performance after a benchmarking activity. Benchmarking enables the SME' to identify the key processes that need improvement, and to search for applicable solutions

from the best in class. Majority of the respondents were also in agreement that benchmarking activities developed for SME's must be specific to the environment and constraints of these organizations if the implementation of the practices identified by such activities is to succeed and result in increased performance . Benchmarking at the SME' facilitates learning and understanding of the organization and its processes shown, greater environmental uncertainty and limited resources are some of the aspects that would require the development of benchmarking practices that are specific to SME's if these practices are to be adopted effectively.

From the findings SME's need to improve its quality, profitability and competitiveness brought about by rapid and important changes in the business environment shown by a mean score of 2.1429, benchmarking allows the SME' to achieve continuous improvement by quickly signaling deterioration in its competitiveness or identifying areas that need to be adjusted shown by a mean score of 2.2857 and knowledge generated by researchers during benchmarking allows SME'S, with their limited resources, to better justify their decision to engage or not to engage in benchmarking activities.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings from chapter four, and also gives conclusions and recommendations of the study based on the objectives of the study.

5.2 Summary of the Findings

From the findings, the study established that benchmarking is used at the SME's as an incremental continuous improvement tool. The study also established that SME's apply implementation of significantly better practices, careful study of own practices and performance, development of recommendations, analysis of results and a thorough search to identify best-practice-organizations.

The study also established that SME's apply benchmarking strategies such as internal benchmarking (benchmarking against internal operations or standards) and operational benchmarking and industry (or competitive) benchmarking (benchmarking against other companies in the same industry) and process (or generic) benchmarking (benchmarking generic processes).

On the extent that various factors contribute to the successful implementation of benchmarking at the SME's, the study established that the factors that contribute to the successful implementation of benchmarking at the SME's were such as being composed of interested motivated people and identification of targets in advance, being tied to the SME's overall strategic objectives, setting realistic timetables,

understanding the processes behind the data and picking the correct business partners and allies.

On the extent that various benefits of benchmarking enhance the overall business performance realized by the SME', the study established that it helps to change internal paradigms and "see out of the box", it creates awareness of industry good practices and supports the quest for a competitive position, determines authentic measures of productivity and enhance high payoff in terms of quality and customer satisfaction, provides an insight into prevailing business performance and helps in the implementation of change.

On the extent that benchmarking help in improving the various financial performance measures of profitability at the SME's, the study found that it improves revenue growth, and also operating profit margin, net profit margin and net firm income from operations, operating margin and rate of return on equity and gross profit margin, return on capital employed (ROCE) and rate of return on assets.

On the extent that benchmarking lead to improvement in various areas at the operational level within the SME', the study established that benchmarking lead to quality improvement in various areas at the operational level within the SME' such as customer satisfaction, process management and process efficiency and process improvement.

5.3 Conclusion

The study concludes that SME'S apply benchmarking strategies such as internal benchmarking (benchmarking against internal operations or standards) and operational benchmarking and industry (or competitive) benchmarking (benchmarking against other companies in the same industry) and process (or generic) benchmarking (benchmarking generic processes). The factors that contribute to the successful implementation of benchmarking at the SME's were such as, being composed of interested motivated people and identification of targets in advance, being tied to the SME''s overall strategic objectives , setting realistic timetables, understanding the processes behind the data and picking the correct business partners and allies.

The study further concludes that benchmarking enhance the overall business performance realized by the SME' by helping to change internal paradigms and "see out of the box", creating awareness of industry good practices and supports the quest for a competitive position, determines authentic measures of productivity and enhance high payoff in terms of quality and customer satisfaction, provides an insight into prevailing business performance and helps in the implementation of change. Benchmarking help in improving the various financial performance measures of profitability at the SME's such as revenue growth and also operating profit margin. Benchmarking also lead to quality improvement in customer satisfaction, process management and process efficiency.

The study also concludes that SME's experience obstacles of insufficient financial resources to allocate to benchmarking and lack of time or resources to allocate to the exercise. The study finally concludes that financial benchmarking had the highest relationship with the SME' performance.

5.4 Recommendations

This study therefore recommends that in order to succeed in its benchmarking activities, the SME's should be vigilant in order to adapt to the changes in the external environment. Since benchmarking alone is not sufficient, the SME's also need vision, energy and teamwork to increase its performance after a benchmarking activity. This would enable them to identify the key processes that need improvement and to search for applicable solutions from the best in class.

For optimal performance to be realized by the SME', activities developed for SME's must be specific to the environment and constraints of these organizations should be solved. Greater environmental uncertainty and limited resources are some of the aspects that would require the development of benchmarking practices that are specific to SME's if these practices are to be adopted effectively.

5.5 Limitations of the Study

Time was a major limitation to the study as it took long when collecting the questionnaires because some of the respondents kept them and never bothered to answer or did not complete the questionnaire, time also on part of the researcher was not as sufficient. Transportation was also a limitation in that due to poor means of communication it took long to visit all branches and this led to arriving when some of the managers had left for meetings and others personal business.

Irrelevancy was another limitation as some of the respondents were new to the SME's and had inadequate information hence giving out data which was not satisfactory or not relevant to the study. Unavailability of key personnel in some SME's, it was difficult to

access the appropriate officer to complete the questionnaire and some of them had very little time to complete the questionnaire. Sample representation was another limitation there was 52% in sample representation although appropriate, a larger percentage in sample representation in future studies could be recommended

5.6 Suggestion for Further Studies

The researcher suggests that further study should be done on the effect of benchmarking on performance in all the SME's in Kenya in order to allow generalization of results.

A study can also be done in other institutions such as MFIs, Banks and Insurance companies so as to provide information on them since each institution has a different strategic approach.

The SME's should have their own policy which facilitates a body that allows access to finances to SME's only to facilitate training on better business practices to improve financial performance.

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APPENDICES

Appendix I: Introductory Letter

DISHON MUNENE M
C/o University of Nairobi,
P.O. Box 30197-00100,
Nairobi, Kenya.

TO WHOM IT MAY CONCERN

Dear Sir/Madam,

REF: MSC FINANCE RESEARCH STUDY

I am a student pursuing a Masters' degree in MSC finance at the University of Nairobi. In partial fulfillment of the requirements to the award of the Masters degree, I am required to carry out a research and write on "Effects of Benchmarking Practices on the Financial Performance of Small and Medium Sized Manufacturing firms in Kenya"

I kindly request your assistance by availing your time to respond to the questionnaire. The information will be treated with utmost good faith and a copy of the final report will be made available to you at your request.

Thank you.

Yours faithfully,

DISHON MUNENE MWANGI

Sign.....

APPENDIX 1I: QUESTIONNAIRE

Section A: Basic Information\You are requested to fill out your personal information in the spaces below. Please tick ()only one response

1. Gender

Male

Female

2. What is your age?

18-25

26-35

36-45

46 and above

3. Level of education

Primary level

'O' level

Certificate/Diploma

Graduate

Postgraduate

4. How long have you worked at the organization?

Less than 5 years

Between 5 and 10 years

More than 10 years

5. What position do you hold in the organization?

Head of department

Assistant Manager

Supervisor

Staff member

SECTION B: BENCHMARKING PRACTICES

6. In what ways do you use Benchmarking at your organization?

As an incremental continuous improvement tool

For major changes of process re-engineering

7. To what extent does your organization apply the following benchmarking practices?

Practices	Very great extent	Great extent	Moderate extent	Little extent	No extent at all
A thorough search to identify best – practice- organization					
Careful study of own practices and performance					
Systematic site visits and interviews					
Analysis of results					
Development of recommendations					
Implementation of significantly better practices					

8. What is the extent to which you apply the following benchmarking strategies at your organization/ Use a scale of 1-5 where 1 = to a very great extent and 5= not at all

Benchmarking strategy	1	2	3	4	5
Internal benchmarking (benchmarking against internal operations or standards)					
Industry (or competitive) benchmarking (benchmarking against other companies in the same industry)					
Process (or generic) benchmarking (benchmarking generic processes against best operations or leaders in any industry)					
Strategic benchmarking (Proactive analysis of emerging					

trends, options in markets, processes, technology and distribution that could affect strategic direction and deployment					
Future benchmarking (looks at technologies associated with business processes and used forecasting techniques to determine what breakthroughs exists among these technologies)					
Product benchmarking					
Financial benchmarking					
Operational benchmarking					

9. To what extent do the following contribute to the successful implementation of benchmarking at the organization?

	Very great extent	Great extent	Moderate extent	Little extent	No extent at all
Being tied to the organizations overall strategic objectives					
Being composed of interested motivated people					
Focus on relevant workgroup level issues					
Set realistic timetables					
Picking the correct business partners and allies					
Following proper protocol					
Collecting manageable bodies of data					
Understanding the processes behind the data					
Identify targets in advance					

10. What tools and metrics are used to support effective benchmarking process at your organization?

.....

.....

.....

SECTION C: RELAITONSHIP BETWENE BENCHMARKING AND PERFORMANCE

11. To what extent are the following benefits of benchmarking enhance the overall business performance realized by your organization?

	Very great extent	Great extent	Moderate extent	Little extent	No extent at all
Team building					
Organizational development					
High payoff in terms of quality and customer satisfaction					
Helps in the implementation of change					
Provides an insight into prevailing business performance					
Establishes pragmatic goals abased on a concerted view of external conditions					
Determines authentic measures of productivity					
Helps to change internal paradigms and “see out of the box”					
Creates awareness of industry and practices					
Supports the quest for a competitive position					

12. To what extent has benchmarking helped in improving the following financial performance measures of profitability at your organization?

Measures of profitability	Very great extent	Great extent	Moderate extent	Little extent	No extent at all
Gross profit margin					
Revenue growth					
Operating margin					
Net profit margin					
Return on capital employed (ROCE) Net firm income from operations					
Rate of return on assets					
Return on equity					
Operation profit margin					

Appendix III: Extent that various benefits of benchmarking enhance the overall business performance realized by SME'Ss

	Very great extent	Great extent	Moderate extent	Little extent	Not at all	Mean	Std. Deviation
Team building	14.3	28.6	42.9	14.3	0	2.571	.9201
Organizational development	0	55.1	16.3	14.3	14.3	2.5714	.74180
High payoff in terms of quality and customer satisfaction	14.3	57.1	28.6	0	0	2.1429	.65060
Helps in the implementation of change	14.3	28.6	57.1	0	0	2.4286	.74180
Provides an insight into prevailing business Performance	14.3	42.9	42.9	0	0	2.2857	.71270
Establishes pragmatic goals based on a concerted view of external conditions	0	57.1	14.3	14.3	14.3	2.8571	1.14550
Determines authentic measures of Productivity	0	85.7	14.3	0	0	2.1429	.35635
Helps to change internal paradigms and “see out of the box”	14.3	57.1	28.6	0	0	1.4029	.65060
Creates awareness of industry good Practices	14.3	71.4	14.3	0	0	2.0000	.54433
Supports the quest for a competitive position	28.6	42.9	28.6	0	0	2.0000	.76980

(Source: Research Findings)

Appendix IV: Extent that benchmarking help in improving the various financial

	Very great extent	Great extent	Moderate extent	Little extent	Not at all	Mean	Std. Deviation
Gross profit margin	14.3	28.6	57.1	0	0	2.429	.7418
Revenue growth	28.6	42.9	28.6	0	0	1.3460	.76980
Operating margin	14.3	42.9	42.9	0	0	2.2857	.71270
Net profit margin	14.3	71.4	14.3	0	0	2.0000	.54433
Return on capital employed (ROCE).	14.3	42.9	28.6	14	0	2.5714	1.19965
Net firm income from Operations	14.3	71.4	14.3	0	0	2.0000	.54433
Rate of return on Assets	14.3	28.6	42.9	14	0	2.5714	.92009
Rate of return on Equity	14.3	57.1	14.3	14	0	2.2857	.89679
Operating profit Margin	14.3	71.4	14.3	0	0	1.4210	.54433

(Source: Research Findings)

Appendix V: Extent that the SME's apply various benchmarking practices

Std. Deviation		Very great extent	Great extent	Moderate extent	Little extent	Not at all	Mean
1.06904	A thorough search to identify best-practice-organizations	28.6	14.3	42.9	14.3	0	2.4286
0.7698	Careful study of own practices and	28.6	42.9	28.6	0	0	2
0.92009	Systematic site visits and	14.3	28.6	42.9	14.3	0	2.5714
1.19965	Analysis of results	28.6	28.6	14.3	28.6	0	2.4286
1.04906	Development of recommendations	28.6	28.6	28.6	14.3	0	2.2857
0.84828	Implementation of significantly better	42.9	28.6	28.6	0	0	1.4571

(Source: Research Findings)