

**INNOVATION AND PERFORMANCE OF THE SMALL AND MEDIUM
ENTERPRISES IN MACHAKOS TOWNSHIP, KENYA.**

BY

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DECLARATION

This research proposal is my original work and has not been submitted for examination to any other University.

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This research proposal is submitted for examination with my approval as the University Supervisor.

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DEDICATION

To my late parents Mr. and Mrs. Agan who believed in the value of education and instilled this in me at a tender age, May your souls rest in eternal peace. To my brothers especially Abel Agan, thanks for the support both financially and emotionally, your contribution has been invaluable this far.

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ABBREVIATIONS AND ACRONYMS

SMEs: Small and Medium Enterprises

MSEs: Micro and Small Enterprises

NGO: Non-governmental Organizations

AT: Appropriate Technology

FI: Financial Institutions

BSC: Balanced Scorecard.

KNBS: Kenya National Bureau Of statistics.

KRA: Kenya Revenue Authority.

LSM: Large Scale Manufacturers.

ABSTRACT

Innovation has become a major topic not only for the Small and Medium Enterprises around the world but also for other sectors of the economy. The benefits of innovation according to a study conducted in Nigeria by Amanakwe (1995), include increasing profit margin, product diversification and differentiation, to meet and exceed needs, securing a market strategic position, create a brand, improve product quality, lowering production cost, improve working environment, improve product flexibility, reduce environmental damage and to replace products being faced out. The main objective of the study was to establish the relationship between innovation and the performance of Small and Medium Enterprises in Machakos Township. The study used a descriptive research design to explain the relationship between innovation and the performance of SMEs in Machakos town. The target population of the study comprised of licensed SMEs in Machakos Township and the data of these licensed SMEs was provided by the Machakos County government. The town was targeted because of the high rate of SMEs decline in the area and because of the variability in the nature of SMEs operating in the area including wholesalers, accommodation and hospitality, agriculture, technical services, manufactures and private education and health service providers. A questionnaire with open ended and closed ended questions was developed and used in data collection. The study found and concluded that process, product, positioning and paradigm types of innovation had a positive relationship with the performance of some business types of the SMEs in Machakos town. The findings showed a close relationship between innovation and performance of SME where those that embraced innovation survived longer and were profitable. It was recommended that embracing innovation after research on which suits which SME best and research also needs to be done on which kind of innovation suits a given entity. The study further suggested considerations like having mechanisms to implement tax incentives, involving key stakeholders in the business types and academia in research and development, develop policies to encourage innovation listed in this study and initiate programs that recognize and reward innovators. The limitations encountered during the study is the unwillingness of the owners of these SMEs to give information about their businesses because of the fear that the information could reach their competitors and later have a competitive edge over them. The study suggested that the same study should be replicated in other counties to compare the findings from these other counties and also to access the extent of innovation and consequently the connection between their impacts on the performance of specific types of business rather than generalizing in the whole SME sector which might not apply to others.

CHAPTER ONE

INTRODUCTION

1.1 Background.

Innovation is defined as the process through which an invention or idea is translated into a good or a service from value can be derived (Kantor, 2001). It further explains that innovation should be able to satisfy a defined need. Invention differs from innovation in that it refers to a more direct creation of an idea which is directly used in the production of a product or service delivery. The understanding of innovation has been interpreted differently in different sectors. For example economists understand innovation in terms of the economic factors and they therefore have taken a more market conclusion rather personal perspective (Kemp, 2003). The study therefore tries to relate how Innovation affects the performance of SMEs.

A number of theories have been put in place to explain this relationship. According to Schumpeter theory of Innovation, Schumpeter (1935) he argued that changes in the economic status results in a response from the environment in which the economy operates which includes also the coming up of new ideas to respond to the competitive nature of the market and demands of the market. Schumpeter argued that these changes result in to the innovation of new ideas to respond to these demands hence the world is always innovates to respond to the ever changing demands of the market. This theory also concurs with the current market trends and how the entrepreneurs respond to these market changes. Another theory that explains this concept is the Imitation Theory of innovation by Marty, A.G (1955) who argued that people tend to copy and improve on whatever is in existence to gain a competitive advantage. This study with therefore seek to find the relevance of

Schumpeter's theory in the SMEs market in Machakos township and discuss its relevance to the market forces and the competition in the market. The study tried to justify how the various SMEs respond to the various needs in the market to fulfill their potential in the market to ensure customer satisfaction and also for the profitability of the business.

According to KNBS (2005), most SMEs do not live to see their second birthday, that is most of them collapse as soon as they are started. This is no exception in Machakos Township where an observation has been made that most of these SMEs collapse within six months of their inception. This study is therefore motivated to seek what causes these collapse and if innovation which has been proved by some studies to aide performance is being practiced by these entrepreneurs. It will also seek to see if there are any differences in performance among the businesses that practice innovation and those that do not and also to analyze the survival ratio of those that practice innovative activities and those that do not. The study will also try to integrate innovation in to the operation of these organizations and understand its viability.

The study will concentrate on the retail outlets in Machakos Township to discover the extent to which these outlets embrace the concept of Innovation. The outlets will include the retail and wholesale shops, pharmaceuticals, Food and accommodation outlets, clothing and textile outlets. Data will be collected from these different sources to include the diverse nature of the SMEs in Machakos. The information from the mentioned sources will be gathered through use of questionnaires and even direct verbal interviews to get more information from the respondents. According KNBS (2005), there are more than 2100

SMEs in Machakos Township alone. The study will concentrate on these businesses and diversity of these businesses will also be considered in the data collection process. The diversity of the businesses will provide the levels of innovation in different sectors of the economy and the variability on the way innovation is embraced by different of the SME business.

1.1.1 The Concept of Innovation

Innovation is defined as the process through which an invention or idea is translated into a good or a service from value can be derived (Kantor, 2001). It further explains that innovation should be able to satisfy a defined need. Invention differs from innovation in that it refers to a more direct creation of an idea which is directly used in the production of a product or service delivery.

The understanding of innovation has been interpreted differently in different sectors. For example economists understand innovation in terms of the economic factors and they therefore have taken a more market conclusion rather personal perspective (Kemp, 2003). They further argue the forces of demand and supply affect the rate at which innovations are developed as Ruttan (1984) noted that scarcity is the mother of inventions. Schumpeter (2000) simply defined it as carrying new combinations; therefore these new combinations should come with new product features which are market friendly.

Innovation has been applied in several areas that is product, process and even market. Product development which involves creating entirely new set of products and the firms involved in such initiatives tend to last longer than the conservative ones (Kemp, 2003). It

has been noted that businesses that come up with new ideas tend to last longer are always very competitive in the market. The good examples in Kenya are Equity bank and in the telecommunications sector Safaricom limited. Safaricom came up with a money transfer service called Mpesa which is now known globally and this has helped Safaricom to diversify her revenue sources and also avoid overreliance on voice call revenue which faces a lot of competition in the market (Economic Survey Report, 2005). Equity bank has also come up with Equitel which is a money transfer services which makes her customers get everything under one roof hence customer loyalty is greatly improved. This makes innovation cornerstone of almost all successful businesses (Kantor, 2001).

Innovation has helped in the growth of several businesses, however it also back fires on some if the feasibility study is not properly done. Kiraka (2013) notes that the success of many innovations is measured in financial terms which is not always the outcome hence for those who want immediate returns always get disappointed and coming up with innovative ideas involves use of financial and human resources in the business which might not be available. Studies have also various benefits that come with innovation. Hafeez (2013) for example mentioned product diversification, creating new markets, customer loyalty, brand awareness, business survival for a long time and meeting the customer expectations as some of the few benefits that come when a business embraces innovation.

1.1.2 Business Performance

Performance is often defined simply in terms of output terms such as quantified objectives or profitability. Barambah in Armstrong (2006) defines performance as both behavior and results. This definition covers the achievement of expected levels as well as objective setting and review. The underlying thought behind this study is actually to investigate this relationship bearing in mind that if the behavior of management is right, then the expected levels of output will be achieved (success) and vice versa for failure.

Success and failure are taken as the two ends of the performance continuum.

Many authors have tried to set out a clear definition of performance but this debate continues to date within the academic literature, more so regarding some aspects of terminology issues, analytical levels, and the conceptual basis for assessment. According to Ginsbert (1985), “There are three different levels of performance within organizations”. They are distinguished as the financial performance, business performance and organization effectiveness, although the latter has been subsequently known as organizational performance. Performance is the key interest of every business manager or owner. The overall performance of the organization depends on proper management of the three levels, which fall within the jurisdiction of top, middle and lower management.

1.1.3 Innovation and Business Performance

Research studies have revealed that innovation has a positive relationship with the performance of SMES. For example, Sule (1986) argued that a firm that can be regarded as micro or small in an economically advanced country like Britain, given their high level of capital intensity and advanced technology, may be classified as medium or even large in a developing country like Nigeria. Definitions also change over time, owing to changes in price levels or advances in technology and these can be changed by proper investment in innovation. In the United States, the Small Business Administration (SBA, 2003) has various definitions for small businesses depending on the type of industry. Manufacturing and mining businesses with fewer than 500 employees are considered small businesses while businesses in wholesale trade enterprises must have fewer than 100 employees.

Previous research has shown that a number of factors affect the performance of MSEs especially insufficient capital or financial resources. However, the degree to which limited financial resources alone are a major obstacle is still debatable. A Study by Harper (1996) found that additional capital is often not required and can be overcome through creativity, initiative and innovation. Kallon (1990) found that the amount of capital needed to start a business is significantly negative when related to the rate of growth for the business. He also found that access to commercial credit from FIs did not contribute to entrepreneurial success in any significant way. On the other hand, some researchers have argued that small businesses are undercapitalized.

Business owners in Africa tend to depend upon their own savings or family savings and this makes access to capital a challenge. Most of them cannot meet the requirements for commercial loans, and those who do find such loans expensive (Cooley, 1997). Kallon (1990) also found out that 67.6% of the firms studied depended entirely upon personal savings for capital, 11.9% had access to family savings, 9.2% used commercial banks and other FIs and 7.9% drew resources from partners, shareholders, and other sources.

Administrative problems have also been cited as a major cause of failure for small businesses. According to Kazooba (2006), poor recordkeeping and a lack of basic business management experience and skills were major contributors. Researchers also identified inexperience in the field of business, particularly a lack of technical knowledge, plus inadequate Managerial skills, lack of planning, and lack of market research (Lussier, 1996).

1.1.3 Small and Medium Enterprises in Kenya

The Small and Medium enterprises (SMEs) play an important role in the Kenyan Economy. According to the Economic Survey (2006), the sector contributed over 50 percent of new jobs created between the year 2005 and 2010. Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007). According to KNBS (2005), one of the most significant challenges is the negative perception towards SMEs. Potential clients perceive small businesses as lacking the ability to provide quality services and are unable to satisfy more than one critical project simultaneously.

Often larger companies are selected and given business for their clout in the industry and name recognition alone. Starting and operating a small business includes a possibility of success as well as failure. Because of their small size, a simple management mistake is likely to lead to sure death of a small enterprise hence no opportunity to learn from its past mistakes. Lack of planning, improper financing and poor management have been posited as the main causes of failure of small enterprises (Long, *et al.*, 2006). Lack of credit has also been identified as one of the most serious constraints facing SMEs and hindering their development (Kiraka, 2013).

The capacity of SMEs to meet the ever growing expectations of the customer will be determined by their ability to come up with new products and innovations. This will be possible if they read effectively the changing marketing trends and adapt to them effectively.

Given the role played by SMEs in Kenya, a study that specifically addresses factors within the business environment that affects their performance potential is very important. In line with Kemp (2003) explain that the rate of economic growth is directly proportional to the rate of investment, factors in the business environment which constrain investment could in turn be the root cause of the poor economic performance of the manufacturing sector in Kenya. The removal of the impediments to entrepreneurship could be a powerful mechanism for growth.

1.1.4 Small and Medium Enterprises in Machakos Township

According to the 2005-2010 District Strategic plan, Machakos town is one of the towns in Machakos County Kenya's first administrative headquarters. It covers an area of around 1,623.9 sq. Km² and had an urban population of 1.098 Million people. It's the home to Machakos county Offices and borders Nairobi county and Kiambu County to the West, Kitui County to the East and Makueni County to the south. Following the introduction of the county government structure, this county has been in the limelight due to the several development projects she has initiated. The development of the infrastructure and her vicinity to the Jomo Kenyatta international airport has been the major growth boosters of this county specifically Machakos town.

The 1999 National Baseline Survey conducted by the Central Bureau of Statistics, ICEG and K-Rep Holdings provides the most recent comprehensive picture of SMEs in Machakos. KNBS (1998) observes that the health of Machakos economy as a whole has a strong relationship with the health and nature of small and micro enterprise sector. When the state of the macro-economy is less favorable, by contrast, the opportunities for profitable employment expansion in SMEs are limited. This is true especially for those SMEs that have linkages to larger enterprises and the economy at large, given this scenario, an understanding of the dynamics of SMEs is necessary not only for the development of support programs for SMEs, but also for the growth of the economy as a whole.

1.2 Research problem

The turbulent nature of the market depending on the product or service the business has to offer makes it necessary for the business to engage in innovative activities to cater for the ever changing needs of the customers, due to this, most SMEs in Machakos have failed to see their second stage of growth. The competitive nature of the market, customer behavior and need change, globalization, scarce resources and low life span of SMEs are some of the challenges being faced by SMEs. It therefore means taking up innovation is critical for the survival of these SMEs (Kiraka, 2013). Starting and operating a small business comes with a possibility of success as well as failure, this study therefore sought to explore the relationship that exists between innovation and performance of SMEs.

The study concentrated on the retail outlets in Machakos Township to discover the extent to which these outlets embrace the concept of Innovation. The outlets will include the retail and wholesale shops, pharmaceuticals, Food and accommodation outlets, clothing and textile outlets. Data was collected from these different sources to include the diverse nature of the SMEs in Machakos. The information from the mentioned sources was gathered through use of questionnaires and even direct verbal interviews to get more information from the respondents.

A study by Amanakwe (1995) in Nigeria on the relationship between innovation and growth of SMEs in Ibo state in Nigeria also brought out a close relationship between their survival, growth and profitability when they embrace innovative ideas and come up with products that outcompete other interested parties in their area of business. P.A, G (1995)

in Paris also compared innovation and competitive advantage and realised that firms that embraced innovation always had a competitive edge over their competitors. Another study conducted by Rosli, M.M (2013) in Malaysia on the impact of Innovation on the performance of SMEs and it also found there exists a positive relationship. Ruttan, (1984) in New York also found out the positive relationship between performance and innovation in his study of Innovation and performance of SMEs. It outlined that organizations that embraced innovation performed better hence survived longer.

Innovation and learning are strongly related to the performance of SMEs. A study by (Ruth, 2011) found a strong correlation between the two elements. Kiraka, (2013) also did a study on “Innovation and Small, Micro and Medium Enterprises in kenya” and he found out the growth was more significant in those MSEs that embraced innovation and came up with new ideas. Wanjiku, (2013) also did a study on the innovation and Performance of MSEs in kiambu and her findings were that innovation was dependent on several factors like the level of education and the experience in the business. Muluku, and Odhiambo, (2013) also found a close relationship between Innovation and performance in their study on effects of Innovation on performance of MSEs.

There however still exists a gap on how innovation aid the performance of SMEs and how the customers embrace the idea. The study therefore sought to find out the extent of SMEs engagement in Innovation in Machakos County. What challenges do they experience in the process and most importantly, what impact does innovation have on the performance of these SMEs?

1.3 Research Objectives

The objective of the study is to determine the impact of Innovation on the performance of SMEs in Machakos Township in Kenya.

1.4 Value of the Study.

The findings of this study will help SMEs in Kenya and other regions, with an insight into the benefits of using sound financial planning and management to predict the success or failure of the businesses, based on the orientations prevalent and therefore choose what would be the best outfit for their practice as a continuous performance strategy.

The government of Kenya and Machakos County government can use the findings for the research to assist in policy formulation and development of a framework for critical management factors affecting the performance of SMEs enterprises in Kenya. Policy-makers will use the knowledge and data to adjust or strengthen the position in businesses policy formulation.

Non-Governmental Organizations (NGOs) and other Development Partners dealing with poverty eradication will also find the report useful. The results of this study will be disseminated in workshops and published and stored in libraries thus it will contribute to the stock of knowledge.

Findings from this research will assist academicians in broadening of the syllabus with respect to this study hence providing a deeper understanding of the critical management factors affecting the performance of SMEs. The banks and the financial institutions will be in a better position to understand the challenges.

The study will also assist in the allocation of funds both national and in the county government set ups especially the Constituency Development Fund which is allocated to various constituencies and other development funds especially from the world bank which can be used to develop these SMEs to promote their growth and survival in future and also to enhance their productivity in terms of profits and expansion.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews the available related literature. The literature is reviewed under the following headings: theories of Innovation, the relationship between SMEs and Innovation, Various types of Innovation and the relationship between Innovation and Performance of SMEs and a summary of literature review and conceptual framework.

2.2 Theoretical Foundation

Innovation is defined as the creation of new wealth or the enhancement of the existing products or services to generate wealth, Kemp, (2003). Currently world over, innovation is a concept being applied in every sector of the economy to promote the profitability and the performance of various businesses. Under this study we shall consider Schumpeter theory of Innovation and Imitation theory of innovation.

2.2.1 Schumpeter Theory of Innovation

According to Schumpeter (1935) Innovation is a specific process that is distinct from the combinations commonly carried out in the production process. In fact, although production is nothing other than a particular combination of productive forces, defined as coefficients of production or functions of production, in linking input and output, innovation must be put into focus.

Schumpeter's theory therefore states that whenever an economy or a sector of an economy adapts itself to a change in its data in the way that traditional theory describes, the economy or an industry or some firms in an industry do something else, something that is outside of

the range of existing practice. It specifies that innovation could occur from within itself and not as a response to an event. He therefore further states that, if at a given moment, the same quantity of a good or a product costs less than previously or if the cost of productive factors has not decreased, that means that innovation has occurred.

There have been however a lot of critics of the theory. Critics argue that Schumpeter does not analyze the social conditioning of economic phenomena and that he does not consider institutions.” According to Marty (1955), Schumpeterian vision sees only a simple combination of factors in the enterprise or production, leading to a specific product.

2.2.2 Imitation theory of Innovation

Schumpeter (1935) argued that most innovators tend to imitate what other people have come up with therefore they end up improving the quality and the efficiency of the process or the product designed by the previous individual. This practice has been in place for a long time and it has helped in the improvement of processes and procedures hence making the turnaround time of production feasible and efficient.

Imitation theory states that the already invented practices are improved according to the time dynamics and the changes in technology which renders the previous practices obsolete; hence the improvements are worthwhile in the improvement of the processes involved. Ruttan (1984) reasons that innovation is a continuous process hence imitation is also handy in the improvement of the already established processes to make them cost effective and easier to apply as per the market demands.

This theory has however faced a lot of criticisms. Marty (1955) argues that imitated things are never original hence can never be patented hence innovators are always encouraged to come up with their original to make them acquire the patent rights and also be unique in the market to promote the trust of their customers hence retain them.

2.3 Innovation and Market dynamics

This involves the analysis of how product, process or market or niche innovation affects the application of innovation in the market. Kantor (2001) explains that process innovation is concerned with creation of techniques and improvements of processes and systems. This will help in improving the efficiency of the operations and making sure that time is not wasted on issues that are not profitable to the business.

This involves the creation of new products from new materials or altering the existing products so as to meet the customer expectations. It can also involve the introduction of new materials or products in the market. Ruttan (1984) explains that product innovation is made by coming up with new ideas. This involves serious market research and coming up with products that are technologically produced to speed up the rate of production. He also argues that this will help in attracting new customers and also exploring new market segment to increase on the customer base.

Porter (1990) argued that product innovation is one of the important strategies a business can use to gain competitive advantage over others in the market. Muluku & Odhiambo (2013) also found out that there is a positive relationship between innovation and business performance. This they found out in their study research study and innovation and performance of MSEs and it was realized that there is a positive correlation between the

two. Rosli (2013) also found out the existence of a close relationship between innovation and SMEs performance. He found that businesses which had more innovations performed better and had a competitive edge over their competitors in the market. This was due to the unique nature of their products and the existence of the competitive advantage.

2.4 Benefits of Innovation in Organizations

Innovation is critical for the performance and survival of businesses in the market. This is because of the competitive nature of the markets and the increasing demands of the customers. This means new or improved products must be put in place to improve the customer experience and hence retain them (Chesbrough, 2010)

Innovation also helps in the development of new products and services. This helps in providing variety for the customers and makes them stick to the products of the business. Improvement of the products is also another way of taking care of the needs of the customer in the turbulent world market (Kemp, 2003). Innovation also helps in shaping the life of the business hence her lifespan is prolonged and the business is able to survive for a long period of time. Growth of the business is also promoted as more customers are brought on board. Apart from the growth of products, innovation has also help to improve on the research and development of various products hence new innovations are brought into place to take care of the ever changing needs and preferences of the customers.

Innovation is also a very important tool for the development of the competitive advantage over the competitors (Porter, 1990). It makes the business to have unique products which

attend to unique customer needs hence most of those customers are retained in the business. This helps in improving the customer loyalty to the business and the sales turnover of the business will automatically improve.

The survival of the business is also dependent on how innovative the business is (Polevoi, 2003). He found out the businesses that come up with new products are able to weather the storm of change in the customer tastes and preferences. This helps in the performance and the growth of the business and this makes it survive.

2.5 Empirical Studies and Research Gaps

Schumpeter (1935) argued that a business without innovation and entrepreneurship cannot stand the test of time. This concept has been proven by several studies which have shown a positive relationship between innovation and the performance of SMEs. Several scholars have noted this import and have come with varied conclusions on this relationship. The survival of the business is also dependent on how innovative the business is (Polevoi, 2003). He found out the businesses that come up with new products are able to weather the storm of change in the customer tastes and preferences. This helps in the performance and the growth of the business and this makes it survive.

Innovation and learning are strongly related to the performance of SMEs. A study by (Ruth, 2011) found a strong correlation between the two elements. Kiraka, (2013) also did a study on “Innovation and Small, Micro and Medium Enterprises in kenya” and he found out the

growth was more significant in those MSEs that embraced innovation and came up with new ideas. He however noted that not all innovative activities were successful, some faced rejection from the markets where consumers maintained status quo and were always afraid to try new products and hence stuck to what they already believed in hence convincing them to purchase the improved product or service was a serious challenge.

A study by Amanakwe (1995) on the relationship between innovation and growth of SMEs in Ibo state in Nigeria also brought out a close relationship between their survival, growth and profitability when they embrace innovative ideas and come up with products that outcompete other interested parties in their area of business. Wanjiku, (2013) also did a study on the innovation and Performance of MSEs in Kiambu and her findings were that innovation was dependent on several factors like the level of education and the experience in the business.

There however still exists a gap on how innovation aids the performance of SMEs and how the customers embrace the idea. The study therefore seeks to find out the extent of SMEs engagement in Innovation in Machakos County and also challenges do they experience in the process and most importantly, what impact does innovation have on the performance of these SMEs.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methodology that was be employed by the researcher to carry out the research. It describes the type and source of data, the target population, sampling method and techniques that will be used to select the sample size. It also has information how data was be collected and analyzed.

3.2 Research Design

The study design involved the use of cross sectional survey. Glasgow (2005) also indicated that survey design will require information from those who will use the data and those who will be doing the survey. Survey studies the characteristics of whole population. In this case specific information needed to describe the relationship between innovation and Performance of Small and Medium Enterprises.

A cross sectional survey tries to discover answers to who, what, where, how much and how many type of questions (Cooper &Schindler, 2003). It also attempts to capture attitude of past behavior. Survey studies the characteristics of whole population. In this case specific information was needed to describe the relationship between innovation and the Performance of Small and Medium Enterprises.

3.3 Population of the study

Target population as a set of the study of all members of a real hypothetical set of people, events or objects to which a researcher wishes to generate the results. The study targeted 310 small scale enterprises in Machakos Municipality. The focus was on how these enterprises embrace the concept of innovation and how apply it in their day to day activities.

The study therefore concentrated on specific sectors for example food and beverage outlets, the researcher will consider 50 traders, clothing outlets 40 traders, hardware stores 20, pharmaceutical stores 10 entrepreneurs and finally wholesale and retail stores will consider 60 outlets.

3.4 Sampling

Sampling design is a process by a relatively small number of individuals, objects or events are selected and analyzed in order to find out something about the entire population from which it was selected (Kuul, 1994). A stratified sampling technique was used to ensure that certain sub-groups in the population are well represented in the sample population to their numbers.

The population was divided into homogenous sub-groups known as strata; from each stratum a random sample is selected. Strata samples are then combined to represent the population as shown in Table 3.4. A stratified random sampling of 90 enterprises was selected based on 30% of the target population as shown in Table 3.4 below.

Table 3.4 Study Sample

Category	Frequency	Sampling Ratio	Sampling Size
Food and Beverages outlets	90	0.3	27
Clothing Retail Outlets	60	0.3	18
Hardware Stores	30	0.3	9
Pharmaceutical outlets	20	0.3	6
Wholesale and Retail stores	90	0.3	27
Total	290	0.3	80

3.5 Data Collection

The researcher collected data using non experimental method which included questionnaires and personal interviews. A questionnaire is a concise pre-planned set of questions designed to yield specific information to meet a particular need for research information. A carefully and informative questionnaire aimed at eliciting right responses was constructed and piloted in order to detect any challenges the businesses face. To complement the responses from the respondents to the questionnaire, the researcher conducted face-to-face interview with some of them.

3.6 Data Analysis

The data collected was analyzed using descriptive statistics. This was represented in percentages, tables, chart and graphs. The data was first edited and coded to get relevant data to address the research questions under the study. The data was analyzed both quantitatively and qualitatively. The data was presented through report writing, graphs, tables, pie-charts and use of central tendencies.

The presentation of data was also done through the use of pie charts, graphs and tables. This will give a figurative and an analytical framework to analyze the various results of the study to come with accurate feedback for the users. Graphs also helped in further analysis of the outcomes to make it understandable to the users and for easier analysis.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSIONS

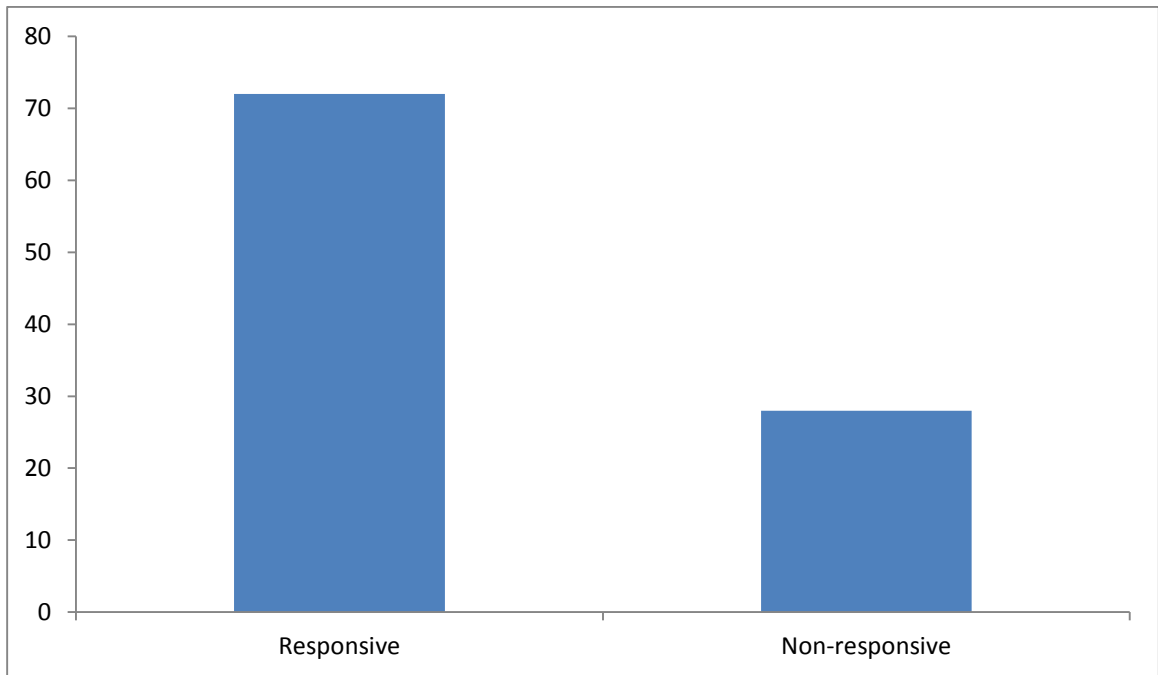
4.1 Introduction

This chapter presents the results and discussion of the study which sought to determine the influence of innovation on the performance of Small and Medium enterprises in Machakos Township. To achieve this, data was collected and captured for analysis first by looking at product innovation performance and by analyzing the relationship of both innovation and performance of the Small and medium enterprises. The data is summarized and presented in the form of percentage scores, frequency count tables and figures.

4.2 Response Rate

Data was collected from eight different SME types located in Machakos town. Respondents' samples were 80 out of which 57 of them responded translating to 71.25% response rate which is regarded as average and hence yield a clear picture of the objectives under investigation. This response rate therefore conforms to Mugenda and Mugenda, (2003) who asserted that a response rate of 50% is adequate for analysis and reporting, a rate of 60% is good and a response rate of over 70% is excellent. The response rate of over 70% is attributable to the friendly and welcoming nature of the respondents.

Figure 4.1 Response rate



Response rate

Source: Field Data (2015)

4.3 Respondents Demographic Profile

The demographic detail entails the respondents' gender, age, level of education, SME operational experience in years and the specialized skills possessed. The findings were presented as follows;

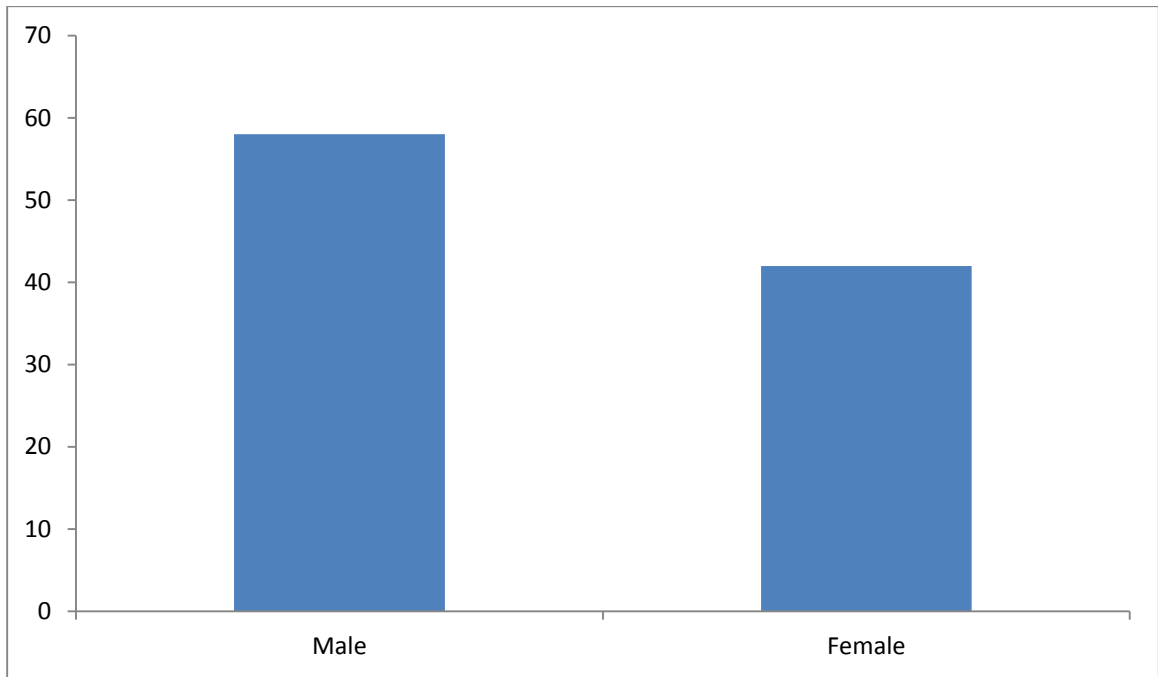
4.3.1 Gender

The study sought to establish the gender of respondents who participated in this research.

A simple majority of 58% were male while 42% were female as shown in figure 4.2.

These findings show that there is a fair gender distribution and therefore a sign of diversity among the SMEs in Machakos town.

Figure 4.2 Gender



Respondents by Gender

Source: Field Data (2015)

4.3.2 Respondents Age Group

The researcher made the decision to divide the respondents' age into different reasonable ranges from 25 to above 50 years. From the responses received, majority of the respondents fall in age bracket of 30-34 years with 29%, while both years 35-39 and 25-29 represented with 28% each. The age group 50-54 followed with 7%, 40-44 years with 5% and 45-49 years were 3% as shown in figure 4.3. Therefore, the representation shows that the people who participated in the study were mature and that majority of SMEs in Machakos town comprised of mixed age groups, mostly the youth and this is an indication of an informed opinion.

Table 4.3: Respondents Age

Age of the Respondent	Frequency	Percent
Below 25	0	0
25-29	16	28
30-34	17	29
35-39	16	28
40-44	3	5
45-49	2	3
50 and Above	4	7
TOTAL	57	100

Source: Field Data (2015)

4.3.3 Level of Education

The study also sought to know the respondents level of education. Majority of the respondents, which is 43.6% fell under the category of secondary school level. Out of all the respondents only 0.7% were illiterate, 4.6% were primary level certificate holders. The study further established that 36.3% of the respondents were diploma certificate holders and 11.3% and 3.5% were undergraduates and post graduate certificate holders respectively. This therefore means that a majority of entrepreneurs had basic education and had a potential of acquiring new business ideas and skills for further growth of their businesses. Table 4.4 below illustrates.

Table 4.4: Level of education

Level of Education	Frequency	Percent
None	1	0.7
Primary	3	4.6
Secondary	25	43.6
Diploma	20	36.3
Undergraduate	6	11.3
Post graduate	2	3.5
Total	57	100

Source: Field Data (2015)

4.3.4 Small and Medium Enterprises Operation Experience

The study also sought to know the number of years the respondents have been in operation. 2.8% of the entrepreneurs were found to have served in their businesses for a period of less than one year. 6.6% of the respondents had 1-2 years of experience, 9.2% had 2-3 years of experience, 28.6% had 3-4 years and finally 52.8% had more than 5 years of experience. This is a strong indication that most of the SMEs were dominated by experienced entrepreneurs. Table 4.5 below illustrates.

Table 4.5: SMEs Operation Experience.

Experience in Years	Frequency	Percent(%)
Less than 1 year	2	2.8
1-2 Years	4	6.6
2-3 Years	5	9.2
3-4 Years	16	28.6
Over 5 Years	30	52.8
TOTAL	57	100

Source: Field Data (2015)

4.3.5 Specialized Skills

The study also sought to determine the specialized skills of the respondents. The study found that 72% of the respondents had no specialized skills and only 19% recognized the specialized skills that they possessed. The remaining 9% were not aware whether they had those skills or not. The results are summarized in below table 4.6.

Table 4.6: Specialized Skills

	Frequency	Percent (%)
Yes	41	72
No	11	19
Not Aware	5	9
Total	57	100

Source: Field Data (2015)

4.4 Type of Businesses

On the types of businesses, the various registered types of business as obtained from the county government of machakos, the researcher calculated a percentage of each as per the figures to arrive at 15% wholesalers, 4% informal sector, 4% transport sector, 26% agriculture, 6% hospitality, 26% agriculture, 20% technical services, 4% private education and health and 21% manufacturers. This indicates that almost all types of business were represented and hence cuts across all SME types. Table 4.7 below illustrates.

Table 4.7: Type of Business

Business Type	Frequency	Percent (%)
General trade, retail, wholesale stores	9	15
Accommodation and Catering	3	6
Industrial plants, factories and workshops	12	21
Professional and technical services	11	20
Agriculture	15	26
Private education, health and entertainment	2	4
Informal sector	2	4
Transport, Storage and communication	2	4
Total	57	100

Source: Field Data (2015)

4.4.1 Product Difference

The study also sought to find out the extent of product differentiation in the market. The study found out that products were different from others in the same industry type to a very great extent of 71% and the not different ones were represented by 29% as illustrated in table 4.8.

Table 4.8: The uniqueness of the Products

The uniqueness of the products	Frequency	Percent (%)
Yes	40	71
No	17	29
Total	57	100

Source: Field Data (2015)

4.4.2 Innovation Type

On the types of innovation, the one that was most represented by SMEs in Machakos town according to the study was process innovation with 49%, positioning followed at 39% while product innovation was at 11% while paradigm innovation took 1%. These findings indicate that all types of innovation are being practiced by SMEs in Machakos County the difference is the extent or the degree of practice. Below table 4.9 illustrates the findings.

Table 4.9: Types of Innovation

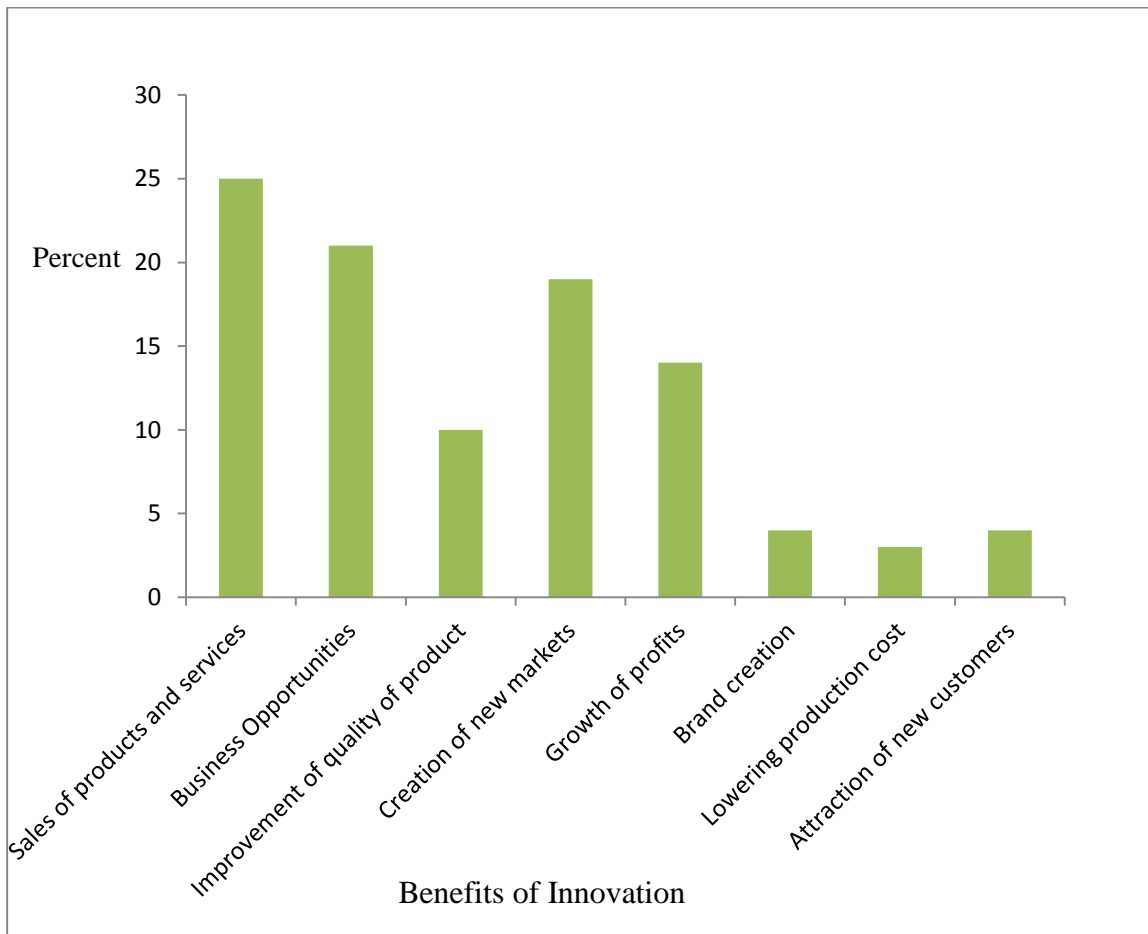
Innovation Types	Frequency	Percent (%)
Product	6	11
Process	28	49
Positioning	22	39
Paradigm	1	1
Total	57	100

Source: Field Data (2015)

4.4.3 Benefits of Innovation

The study also sought to find out the benefits entrepreneurs derive from innovation. From the study, some of the benefits of innovation that were mostly found include sale of products and services, creation of new markets, more business opportunities, improving profits and quality, creating a brand, bringing new customers and lowering production cost. The findings of the extent of the usefulness of innovation are as illustrated in figure 4.10 below.

Figure 4.10: Benefits of Innovation

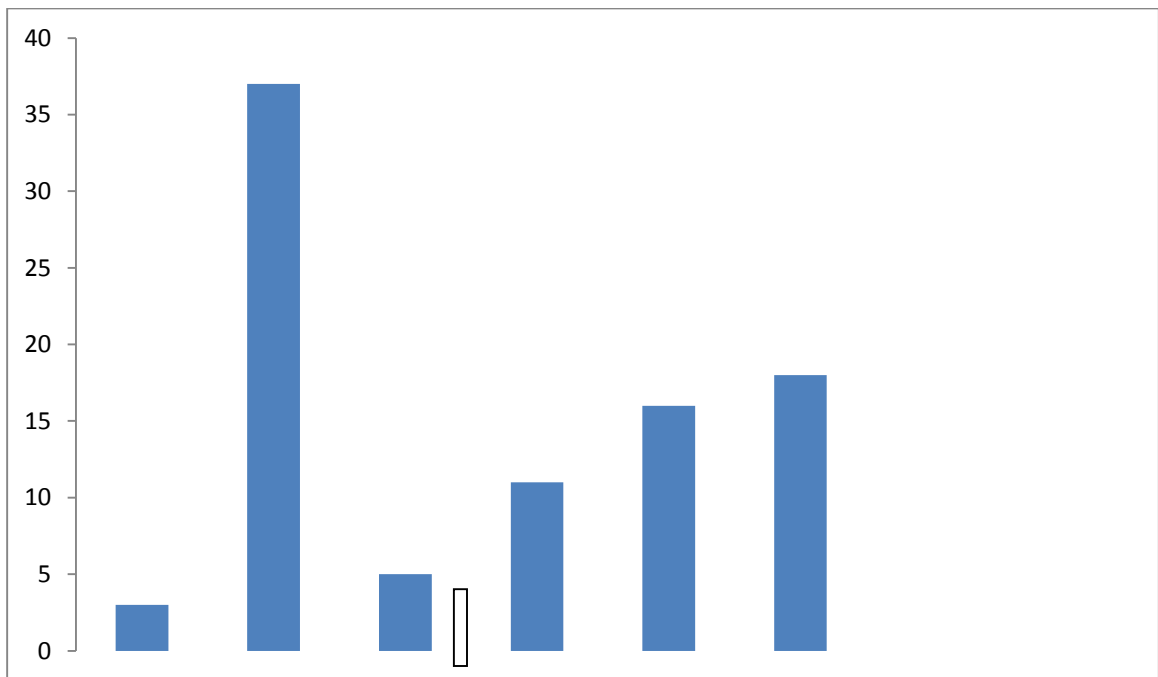


Source: Field Data (2015)

4.4.4 Challenges of Innovation

The study also found out a number of challenges which the entrepreneurs who practice innovation face. The challenges include high cost of investment, lack of proper training, government regulations, loss of focus on existing products, loss of customers and rejection of the products in the market. The specific percentages of the challenges are as illustrated in figure 4.11 below.

Figure 4.11: Challenges of innovation



Source: Field Data (2015)

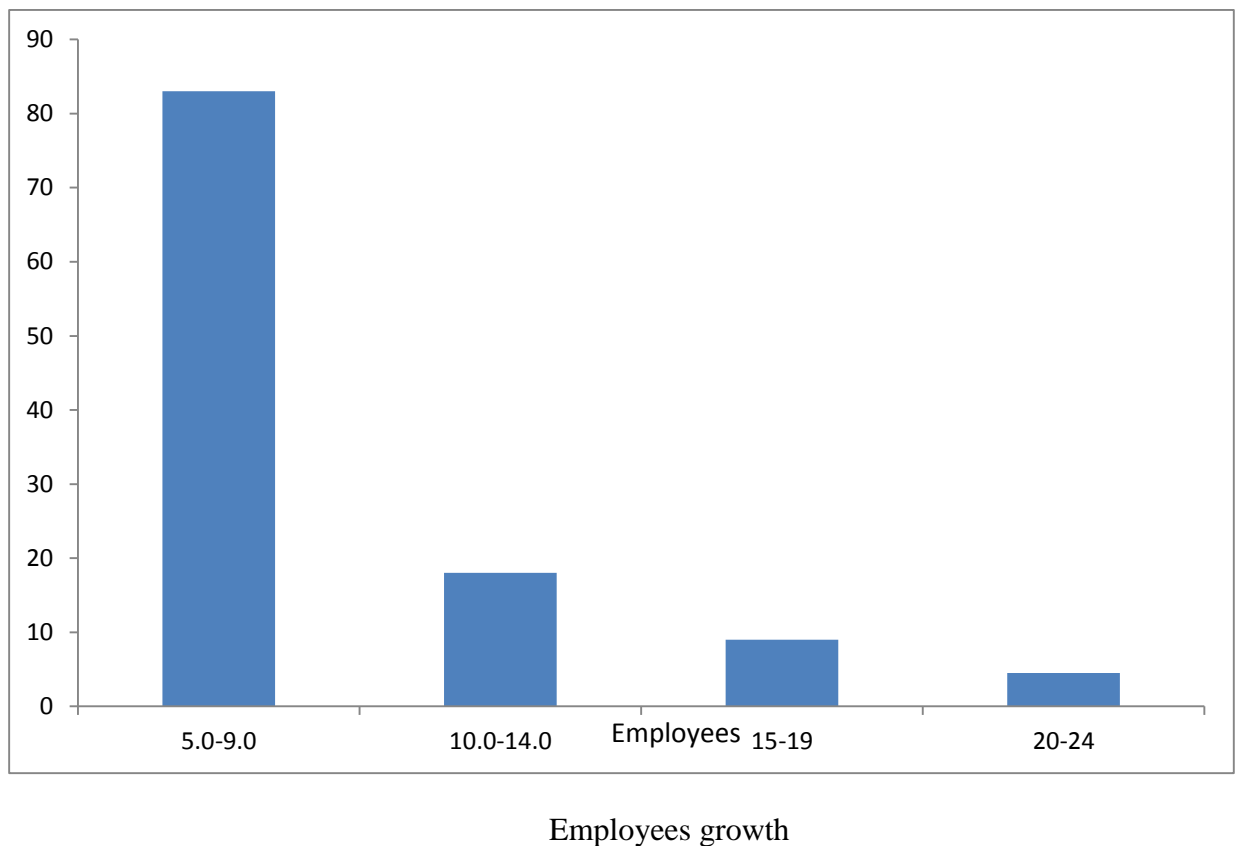
4.5 Performance indicators

The indicators of performance were divided into two categories to simply the extent to which they affect the performance of the SMEs. The categories were grouped into the growth of employees in terms of numbers and average profits per day.

4.5.1 Growth of employee numbers

The study found that most enterprises (83%) had grown within a range of 5-9 employees from when they started adopting innovation while 9% of the businesses had grown within a range of 10-14 employees, 6% of the businesses represented in the range of 15-19 and the rest were in the range of 20-24 employees. This is illustrated in Figure 4.12.

Figure 4.12: Employees Growth



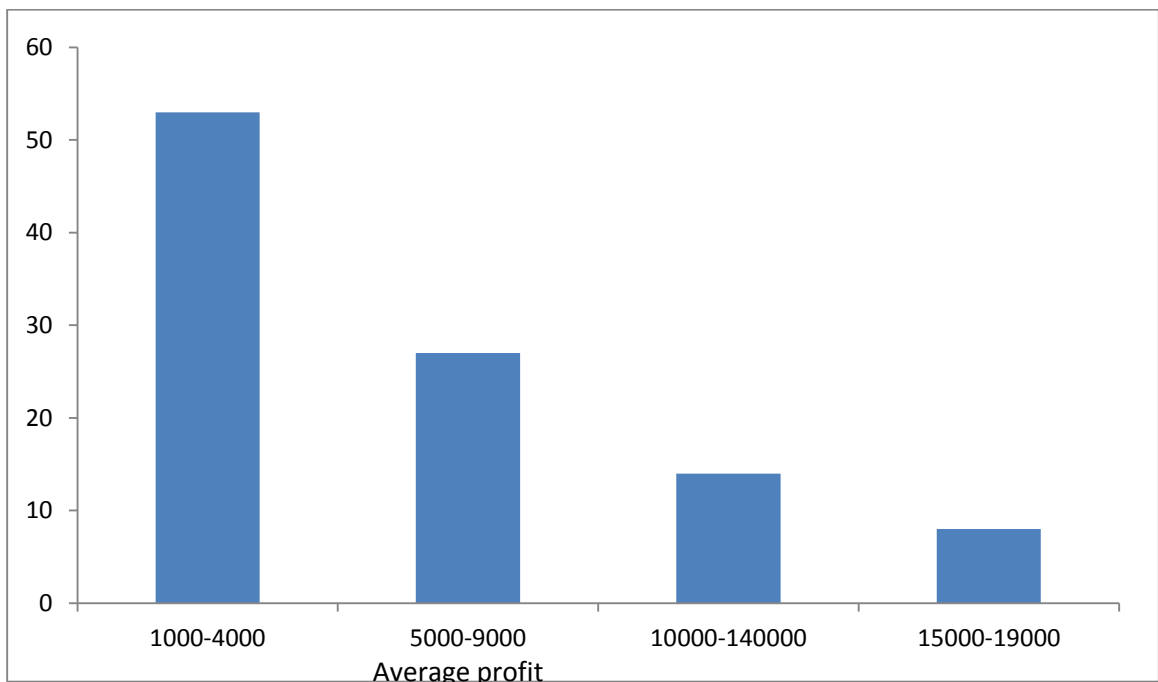
Source: Field Data (2015)

4.5.2 Average profit per Day

The study found out that businesses that made daily profit of between Kshs. 1000-4000 were 53% while those that made between 5000-9000 were 28%. The study further established that some businesses, 16% made between 10000-14000 profit. The rest that took up this study made between 15000- 19000 more since they started being innovative.

This is illustrated in Figure 4.13.

Figure 4.13 Average profit per Day



Source: Field Data (2015)

4.6 Discussion

The discussion of the findings of this study was divided into two categories that is in comparison with the theories of study and also in comparison with the previous studies on the same topic to find out whether the findings are consistent with the existing theories or the previous studies or not.

4.6.1 Comparison with other studies

The challenges in this industry included high cost of investment and government regulations. However the profits, number of employees and branches had grown tremendously on embracing innovation with over 50%, 60% and 40% respectively. This means that performance was influenced positively by innovation. These findings concur with those of Kantor (2001) and Bwisa (2013) who found that process and positioning types of innovation impact positively on performance of small and medium enterprises. From these findings, the relationship between service, product and paradigm innovation and performance of the enterprises was high which concurs with the study by Muluku and Odhiambo (2013) who also found that business performance and some types of innovation as this relate positively.

Industrial plants, factories, workshops businesses in machakos innovated more around paradigm and their products. This resulted to the benefits such as new markets, business opportunities, cutting production cost and reducing environmental damage. The challenges that the study showed they experience were high investment costs, the time it takes for a

product to be accepted, rejection of new products and government regulations. This however indicated that innovation and performance did not have an entire positive relationship with business performance. This indication is similar to that found in a study within this industry on the impact of different kinds of market orientation on product innovation by Zhang and Duang (2010) and another by Freeman (1997) which showed there was no relationship between product and paradigm innovation and the manufacturer industry performance. The findings indicated a strong significance between process innovation and business performance. They also show correspondence with empirical study by Hafeez (2013). “Does Innovation and relational learning influence SME performance” where he found a positive relationship between the two in the professional and technical services industry.

4.6.2 Comparison with the theory

The study findings of the informal sector showed that they were not innovative due to the challenges such as lack of training, not being aware of new technology or methods; wanting to remain authentic and high cost of investment, however most of them had to come up with ways to meet the market demand. This explains the Schumpeter theory of Innovation which states that a change in the economic situation in terms of demand and supply will trigger a response from market which generally results in to innovation. These changes resulted in to the improvement of services through coming up with better technological instruments and also the improvement of the existing products to suit the tastes and preferences of the target market.

A survey by Kenya Revenue Authority, KRA (2007) on the challenges faced by SMEs in Kenya also observed the lack of innovativeness by the informal sector with the same challenges. The innovation theory of Imitation as proposed by Schumpeter was also practiced by several entrepreneurs who copied what had been done by others and later improved on them to create that product or service uniqueness. Imitation was seen both in products and services provided by the SMEs because most of their products or services were more or less similar. The difference was on how these services were being offered and the packaging and how presentable some of these products were.

The challenges that came with innovation included new products rejected by customers, loss of customers, constant change due technological advancements, loss of focus on existing products and governmental regulations. The results showed a fairly positive relationship between process, product and positioning types of innovation and business performance.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter represents the summary of the findings of the study, conclusions, recommendations and areas of further study. The study focused on the relationship between innovation and the performance of SMEs in Machakos Township. It sought to find out if the various types of innovation that is product, process, market and paradigm innovation were being applied and the extent of their application. It also sought to find out the challenges faced by businesses practicing innovation and some of the benefits that come with it.

5.2 Summary of findings

This study investigated the relationship between innovation and the performance of small and medium enterprises in Machakos town. As discussed in the introductory section of this paper, SMEs have been recognized worldwide for their role in wealth generation, employment creation and poverty reduction. According to Kenya's economic recovery strategy for wealth and employment creation, SMEs contribute 18% GDP, plays a critical role in easing foreign exchange constraint, penetrating new markets, stimulating growth and development especially in rural areas.

The sector also acts as the seed bed for entrepreneurial pursuits therefore the need to stay relevant and grow which comes through innovation. Innovation is a dynamic measure that not only sparks growth but also enables businesses to break status quos and leapfrog to superior performance. Consequently, this paper sheds some light on the innovation importance through reviewing past and current relevant literature discussing the

relationship between innovation and the performance of SMEs. The study has revealed a close relationship between innovation and performance of SMEs. However, there are challenges with the market in terms of maintaining the status quo and accepting the value added products and improved services.

5.3 Conclusion

Most of the business in the general trade, retail and wholesale stores type of business were seen to be more innovative in process and position types of innovation. The ones that were indeed innovative recorded to a great extent benefits such as sales of new products, business opportunities, creation of new markets, improve profits, brand creation and bringing in new customers. The small and medium enterprises in the accommodation and catering industry in Machakos township leaned more on service, product and paradigm types of innovation where with that came benefits such as improvement of the quality of the product and services offered, create a brand, business opportunities, creation of new products, improvement of profits and maintaining and bringing in new customers.

The challenges experienced according to the study were high investment cost, loss of focus on existing old products and services and government regulations. The study found that professional and technical services innovated more on the process innovation with benefits such as repeat clients, new clients and more business opportunities and as a result they performed better due to the increase in daily profits, new branches and more employees. The challenges that they faced were government regulations and lack of proper training.

The agricultural types of businesses in Machakos were found to innovate more around process innovation. The benefits recorded include reducing environmental damage,

creating new business opportunities, markets and reducing costs. The challenges faced by the agriculturalists were lack of proper training and not being aware of new products and services. The results from the study indicated no relationship whatsoever between process innovation and business performance. In the private education, health and entertainment industries, innovation was seen in service, positioning and paradigm where benefits achieved included, sales of new products, business opportunities, and improvement of quality of products and services, creation of new markets, improvement of profits, creating a brand and bringing in new customers.

Transport, storage and communication type of businesses were more innovative in the process, product and positioning. The benefits observed here included improvement of sales, creation of new markets, brand creation, reduction in production costs and reduced environmental damage and attracting new customers.

5.4 Recommendations

The findings of the study have shown a positive relationship between innovation and performance of SMEs. The study hence recommends embracing innovation after research which suits the Small and Medium enterprise best, not any innovative activity will lead in to positive results. The study further proposes the following for consideration to stimulate innovation; have mechanisms to implement tax incentives to support high cost innovations, involve key stakeholders in the business types and academia in research and development for innovation, develop policies to encourage in sectors listed in this study such as informal sector that are innovative and other policies to sustain innovation, identify and reward innovative SMEs to promote innovation, initiate programs that tap innovators from when

they are young and to encourage banks and other stakeholders to fund more innovative and viable innovative ideas.

5.5 Limitations of the study

By virtue of their duties, owners of the SMEs are under obligation to treat information about issues, facts and circumstances that they know as confidential. There are obligations and legislation which include provisions that either prohibit the disclosure of information of certain nature this made them uneasy and not ready to open up for the interview. But the researcher tried to assure them that the information given was not going to destroy their businesses.

The issue of unreturned questionnaires and uncooperative responses was also a challenge; this was countered by follow up to improve on response rate. Some interviewees did not return their questionnaire and after doing the follow ups. This was because they were afraid that the information they gave could be used against them which was not the case.

5.6 Suggestions for further Research

This paper proposes a significant framework which can be empirically tested in different Kenyan towns and across different counties in order to be able to generalize the findings. It would be very fascinating to study differences in entrepreneurial benefits of innovation, challenges of innovation, type and extent of innovations and consequently the connection between their impacts on performance of specific business types.

The other area that can be studied and the findings compared to this is the impact of innovation on the performance of large scale manufacturers. A comparison can be made if the impact is the same as those in the SMEs and findings to be compared. This will help in understanding that innovation not only affects the performance of small and medium size enterprises.

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SECTION B: EXTENT OF INNOVATION

1. Are your products different from others in the market?

Yes () No ()

2. Are you using new technology/method in processing your products?

Yes () No ()

3. Types of Innovation

a. Product ()

b. Process ()

c. Positioning ()

SECTION C: BENEFITS OF INNOVATION

1. What are some of the benefits of innovation to your business?

- a. Business Opportunities ()
- b. Sale of new products ()
- c. Improve quality of goods ()
- d. Creation of new markets ()
- e. Improve profits ()
- f. Create brand ()
- g. Lowering production cost ()
- h. Retain customers ()
- i. Bring in new customers ()

Others Specify.....

SECTION D: CHALLENGES OF INNOVATION

High cost incurred ()

Loss of customers ()

High cost of investment ()

Product rejection ()

Government regulations ()

Lack of training ()

Lack of awareness ()

Others

Specify.....

SECTION E: PERFORMANCE MEASURES

Sales turnover per day Average ()

Number of Employees ()

Number of Branches ()

Average Daily Profit ()

Number of Patents, If any ()

Thank you for your Time.

Appendix II: LIST OF SMEs IN MACHAKOS TOWNSHIP

NAME	BOX NUMBER
KITANGA GENERAL	1059 MACHAKOS
MARKETING CONSTRUCTION LTD	1442 MACHAKOS
LEISHA ENTERPRISES	1126 MACHAKOS
KAMWELE FURNITURE	126 MACHAKOS
CREATIVE DEVELOPMENT INITIATIVES	15063 MACHAKOS
MARC MOTORS	1236 MACHAKOS
SIMUNDE SUPPLIES	275 MACHAKOS
BENSTORES HARDWARE	505 MACHAKOS
TITRUS CONSTRUCTION CO. LTD	762 MACHAKOS
TOPROC CONTRACTORS LTD	580 MACHAKOS
EKIMA ENGINEERING WORKS	702 MACHAKOS
LABELLA ENTERPRISES	133 MACHAKOS
NJINET ENTERPRISES	136 MACHAKOS
PENTOIL PETROLEUM LTD	1527 MACHAKOS
FAITH CYCLEMART	1770 MACHAKOS
VISITORS MART	226 MACHAKOS
EBENEZER MUSIC CENTRE	2023 MACHAKOS
DEPA ENTERPRISES	648 MACHAKOS
KINGSWAY CONSOLIDATED	730 MACHAKOS
AGAPE GENERAL STORE	145 MACHAKOS
MAGIC FASHION ENTERPRISES	1360 MACHAKOS
MUMANZI ENTERPRISES LTD	125 MACHAKOS
FAYU STORES	80 MACHAKOS
AMAZON NEAT WEAR BOUTIQUE	818 MACHAKOS
MACHAKOS CO-OPERATIVE UNION	83 MACHAKOS
BERNATA HOLDINGS	1064 MACHAKOS
FRONTFACE CONSULTANTS	611 MACHAKOS
SCOTT BOOK CENTRE	49 MACHAKOS

PARADIGM COMMUNICATIONS	1878 MACHAKOS
CHAMKIM PRIDE AGENCIES	1375 MACHAKOS
WIKWATYO PHARMACY	1522 MACHAKOS
APOLLO BUTCHERY	136 MACHAKOS
BARAKA PHARMACY	699 MACHAKOS
EAST CONSTRUCTION AD HARDWARE	1540 MACHAKOS
STANBOOK EMPORIUM	234 MACHAKOS
JUMBOTEX TYRE CO. LTD	460 MACHAKOS
TYRE WORLD (K) LTD	214 MACHAKOS
BATA SHOES (K) LTD	23 MACHAKOS
GENERATIONS ELECTRONICS	936 MACHAKOS
JOY ENTERPRISES	904 MACHAKOS
BROADWAYS BAKERS LTD	1024 MACHAKOS
KITUI KARIBU ENTERPRISES	253 MACHAKOS
VINYA ENTERPRISES	22 MACHAKOS
CHINESE GENERAL SHOP	1103 MACHAKOS
MASAKU CHEMIST	66 MACHAKOS
MASINGA BOOKSHOP	1665 MACHAKOS
NZAU MILLERS	103 MACHAKOS
T.TOT RESTAURANT	243 MACHAKOS

SOURCE: Government of Machakos County (2015)