THE EFFECT OF FINANCIAL MANAGEMENT PRACTICES ON THE
FINANCIAL PERFORMANCE OF SMALL AND MEDIUM
ENTERPRISES IN KENYA

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DECLARATION

I, Milkah Kemunto Nyakeri, hereby declare that this project is my own work and effort and that it has not been presented in any other university for an award.

Signature: …………………………………...                          Date: …………………

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D61/66890/2010

This management Research Project has been submitted for examination with my approval as the University supervisor.

Signature: …………………………………...                          Date: …………………

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DEDICATION

This research project is dedicated to the following important persons in life:

My dad and mom for the personal sacrifice they made to ensure I got the right education in time allowing me to pursue the course.

All my family members.

May this work be a living testimony to them that: hardwork, patience, unselfishness and prayers always pays abundantly.

To all of you I say thank you.
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This study has been made possible by a number of people and institutions to whom I am heavily indebted to and to whom I would like to express a lot of gratitude to.

The list may be too long to complete. However I would not forget to mention a few of the many who gave their input to present form of the study.

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All small and medium enterprises that participate in my research for providing time and engagement, without their help this research project could not have been successfully written.

I wish to extend my very special thanks to my loving family for their moral support, encouragement and also being there to help me in always possible for the period of the study. To all my friends especially Jacob you are all special in my heart and I am proud to have known you people in my life. The moral support and encouragement you gave me was overwhelming.

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ABSTRACT

Many of the Small and Medium-scaled Enterprises (SMEs) in Kenya are still plagued with management problems. Financial management has been one of the most critical aspects that have threatened the survival of SMEs. The objective of this study was to investigate the effect of financial management practices on the financial performance of small and medium enterprises in Kenya.

The study adopted descriptive research design; it was chosen because it enabled the researcher to generalise the findings to a larger population. The target population for this study targeted all the registered SMEs within Nairobi area. 520 respondents was the target population. From the above population of 520 possible respondents, a sample of 10% was used. Fifty two respondents were selected representing a population of 520 possible respondents using Stratified random sampling by taking 10% of the target population in each stratum. The organised data was interpreted on account of concurrence and standard deviation to objectives using assistance of computer packages especially SPSS version to communicate research findings. Tables and other graphical presentations as appropriate were used to present the data collected for ease of understanding and analysis. A regression analysis was also conducted to measure the importance of each variable.

The study found that inventory, accounts receivable, accounts payable were some of the working capitals that the company uses to manage the business. One of the significant uses of the working capital in the company was inventory which keeps the company running. Majority of the respondents were in agreement that business employed formal inventory control systems, SMEs should have common investments. It was concluded that, inventory management practices in capital management affect the growth of small businesses in that they realize importance of cash management in the process of planning and controlling cash flows. The cash management consisted of three basic components: cash forecasting practices, cash surplus investment practices and cash-control practices. The study also recommends that they should realize the importance of cash management in the process of planning and controlling cash flows. Further, financial structure decisions which include cheaper cost of debt compared to equity; the cost of equity as debt increases; and the benefit of the tax deductibility of debt should be realized.
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CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

The World Bank Review on Small Business establishes the commitment of the World Bank Group to the development of the small enterprise sector as a core element in its strategy to foster economic growth, employment and poverty alleviation. In the year 2004 alone, the World Bank Group approved roughly $2.8 billion in support of micro, small and medium enterprises. There was also a growing recognition of the role that small enterprises play in sustaining global and regional economic recovery (Beck et al., 2002). However, there was little systematic research in this area backing the various policies in support of small enterprises, primarily because of the lack of data. Committee of Donor Agencies (2001) actually suggests that scale-based enterprise promotion is driven by social and political considerations rather than by economic reasoning.

Good financial management is essential for the expansion of your business. Getting your finances in order means your business can work more efficiently and puts you in a better position when seeking funding for growth. Financial management is that managerial activity which is concerned with the planning and controlling of the firm's financial resources. Planning, directing, monitoring, organizing and controlling of the monetary resources of an organization. It involves financing, investing and dividend or how much to distribute and what to retain (Baumbark, 1979).

Today globalization is not just affecting giant companies but also midsize and small organizations, which are beginning to recognize the importance of finance systems that can manage multi-lingual, multi-currency requirements. National borders are losing their importance as the multinational corporate world develops at a rapid pace. Ambitious companies are expanding internationally, and finance managers working in this multinational environment face increasingly complex issues. To be successful, they must understand the challenges and differences of doing business in a foreign country, from differences in international accounting standards, language, and culture to the challenges of domestic and multinational accounting.
Small Enterprises are important for raising the economic efficiency of a country. They are breeding grounds for entrepreneurship, innovations and inventions hence a reservoir for employment. Sustainable jobs, creates income which in turn reduces the level of poverty. In Kenya, the small Enterprises have not grown to any notable impact often citing lack of finance. The Kenyan financial system is marked by a dualistic structure. It is characterized by the existence side by side of formal and informal financial markets (Drucker, 1986). The informal suppliers of credit make up in part for the provision of the financial services. This then raises the issue on what determines whether the financial institutions will advance to the Small Enterprise credit.

1.1.1 The Concept of Financial Management Practices

Financial management can be defined as the management of the finances of an organization in order to achieve the financial objectives of the organization. It broadly embraces two aspects, namely: Financial planning which is a plan to ensure that enough funding is available at the right time to meet the needs of the organization for short, medium or long-term capital. For example how much money is needed to smooth out changes in debtors, creditors and other cash requirements, should a new asset be bought or leased; and Financial control -which seeks to assess whether the plan put forward meets the objectives of the organization in question (Osteryoung, et al; 1997). Financial management components and techniques commonly practiced by the small and medium enterprises include, financial analysis, management accounting, and capital budgeting (Osman, 2007).

Financial management practices in the SME sector have long attracted the attention of researchers. Depending on different objectives, researchers emphasize different aspects of financial management practices. McMahon, Holmes, Hutchinson and Forsaith (1993) and McMahon (1998) summarize their review of financial management practices in Australia, the UK and the USA. In their review the context of financial management practices includes the following areas: Accounting information systems – the nature and purpose of financial records, Bookkeeping, cost accounting, and use of computers in financial record keeping.
According to Olowe, (1999) stated financial management; Financial reporting and analysis the nature, frequency and purpose of financial reporting, auditing, analysis and interpretation of financial performance; Working capital management non-financial and financial considerations in asset acquisition, quantitative techniques for capital project evaluation, investment hurdle rate determination and handling risk an uncertainty in this context; Financial structure management financial leverage or gearing, accounting to lenders, knowledge of sources and uses of finance, non-financial and financial considerations in financial structure decisions and non-financial and financial considerations in profit distribution decisions; Financial planning and control financial objectives and targets, cost-volume profit analysis, pricing, financial budgeting and control, and management responsibility centers; Financial advice internal and external sources and types of financial advice and use of public accounting services; Financial management expertise informal and formal education, training and experience in financial management, relevant qualifications, and overall financial management expertise.

1.1.2 Financial Performance by SMEs

Business enterprises today are mostly practicing knowledge management as an essential input of all business activities to ensure high standards of business performance and accomplishments (Moffett et. al, 2002). Performance management is rapidly become an integral business activity for business enterprises as they realize the competitiveness around decision makers knowledge (Grover and Davenport, 2001). In the main time of business operations shows that Performance management played a significance role for both Small and Medium Enterprises (SMEs). Business growth and the practicing of Performance management are correlated to each other. Higher the growth of the firm, higher the practicing of Performance management will be (Salojarvi et al, 2005). Improved financial performance and innovation of a firm also has a positive connection with the practicing of financial management (Wong, 2005).

Studies results show that SMEs still lack in practicing of financial management. There are various reasons for this. Those reasons include lack of financial and non-financial resources, less top management promise, no financial performance related organizational infrastructure (Chief Knowledge Officer or Chief Information Officer) and misunderstanding about financial performance benefits and its implementation etc. Less work has been done about practicing of
financial performance in SMEs due to the misunderstanding that knowledge management can be similarly practiced in SMEs as it can be practiced in large organizations (Desouza & Awazu, 2006). SMEs play a fundamental role in the growth of economy of any country. Hence those programs should be practiced which can help SMEs in better performing their operations and improving financial results. One of these programs is the practicing of financial management as SMEs benefit from its practices (Wong & Espinwall, 2005).

Measurement is very important and is the only approach to understand whether performance is improving or worsening and whether correction action is needed urgently (Roussel, 2005). But the measurement of the performance of SMEs seems to be difficult and problematic. The performance of SMEs is difficult to assess because of normal fluctuations in activities arising from year to year (Wong, 2005). The principal performance measures are financial returns and firm growth (short and long term) (Cai, et.al, 2009). Performance management has been focusing on SMEs by the use of the return on assets, return on sales and return on investment, and also growth. Growth is based on the composite of the average performance of the return on assets, return on sales and return on investment of the SMEs (BPCI).

Neely, (1995), based on their work on English SMEs stated overall, financial measures are most widely used than another measures for performance measurement in SMEs. They stated difficulty defining new performance measures and training of employees are most important obstacles to the adoption of new performance measures. Regarding that as most small firms are privately held, it is unlikely that CEOs will be willing to provide detailed accounting data on the firm’s financial performance (Altekar, 2005). Therefore selecting subjective, self-reporting measures of financial performance is a well-established approach in management research (Gunasekaran, (2001). Effective financial performance measurement system ought to cover all indicators of financial management that are relevant for the existence of an organization and the means by which it achieves success and growth. This means that any financial performance measurement system ought to include more than just financial measures.
1.1.3 The Context of SMEs in Kenya

Medium enterprises constitute a category difficult to demarcate vis-à-vis the "small" and "big" business categories. The SME industry in Kenya is characterized by the employment of between 50 to 200 employees and capital assets of a substantial amount of about Ksh. 2 million (excluding property). There is no standard definition of SME in Kenya. Lenders ‘definitions vary, but typically they define SMEs as businesses with six to 50 employees or with annual revenues less than 50 million Kenyan shillings. Regardless of the quantitative definition, it is agreed by virtually all stakeholders in this market that SMEs in Kenya are the “missing middle”. Their size and credit demand have outgrown the capacity of microfinance institutions, which offer small, short loans via group-lending methodologies, while the capacity of the SME risk profile combined with the lenders’ lack of sophisticated risk assessment techniques makes many of them appear undesirable as credit customers for business banking.

In Kenya, the Micro, Small and Medium enterprises are variously referred. They fall under the popular informal sector called Jua Kali as they largely start in the open sun under no roof. The sector employs over 80% and is currently receiving a lot of government attention as it’s seen as the solution to the crippling unemployment especially for the youth. Over 65% of Kenyan population is youthful and unemployed. In 2008, Kenya experienced the post-election violence which left over 1,000 people dead and 500,000 displaced. And while this might have been politically instigated, the fuel was the youth unemployment and the grinding poverty. This realization has re-energized the government’s resolve to address the unemployment with such initiatives as kazi kwa vijana. Kenya’s informal sector constitutes 98 percent of all businesses in the country. Kenya, unlike most developing countries, has in official development policies recognized informal enterprise as more than a residual employer for the survival of poor households.

In Seasonal Paper Number 2 of 1992, Small Enterprise and Jua Kali Development in Kenya, the government identifies the small-scale and Jua Kali enterprise sector for support to assist it to "graduate into the formal sector" and to become a major player in the creation of new jobs and economic growth. The term Jua Kali refers to the full range of enterprises employing between 1-
49 workers in all sectors. Access to technical and managerial training, work sites, involvement of Jua Kalis in technological innovation, and creation of a positive enabling environment are key elements in the Government’s Jua Kali development strategy’.

Financial management is the managerial planning and control of financial resources of a business to achieve the objectives of the business (Olowe, 1999). Pandey (1999) defined financial management as that managerial activity which is concerned with the planning and controlling of the firm’s financial resources. The field of financial management is of immense interest to academics and practitioners. This is basically because it is an emerging discipline with many areas where controversies exist, and for which no unanimous agreement has been arrived at.

Practicing managers also find this subject interesting because among the most crucial decisions of the firm are those which relates to finance; and an understanding of the theory of financial management provides them with conceptual and analytical insight to make those decisions skillfully. The scope of financial management is very wide because there exist an inseparable relationship between finance on the one hand and other basic organic functions (Production, marketing, and Human Resources) performed by the organization. Basically all kind of business activities directly or indirectly involves the acquisition and use of funds. For instance, sales promotion policies come within the purview of marketing, but advertising and other sales promotion activities requires outlays of cash and therefore affect financial resources. Recruitment and promotion of employees in organizations is clearly the responsibility of the personnel department, but it requires payment of wages, salaries and other benefits and thus involves finance (Idolor et al, 2003).

Financial management is based on the assumption of shareholders wealth maximization objective (Olowe, 1999). The firm’s investment and financing decisions are unavoidable and continuous. In order to make them rational, the firm must have a goal. It is thus generally agreed in theory that the financial management goal of the firm should be the maximization of shareholders (owners) economic welfare, by maximizing the wealth of shareholders as reflected in the market value of shares (Pandey, 1999). The objective of shareholders wealth maximization (SWM) is an appropriate and operationally feasible criterion to choose among the alternative
financial actions. This is because it provides an unambiguous measure of what financial management should seek to maximize in making investment and financial decisions on behalf of owners (shareholders). Therefore, the performance of the financial manager must thus be evaluated in line with the overall objective of shareholders wealth maximization (Olowe, 1999).

1.2 Research Problem

The small and medium-sized enterprise (SME) sector has an important role to play in developing economies not only in economic development, but also in poverty alleviation and job creation. The sector faces a number of constraints especially in accessing ready supply of their goods and services, marketing logistics; business structures and technology. The sector faces both problems and opportunities that affect finance management. Due to the craving levels of poverty and unemployment in many African countries Kenya inclusive, the government has shown a big interest in Small Enterprises and encourages their unemployed to get involved in these small businesses in order to curb the problem of unemployment.

SMEs are faced with lack or Inadequate managerial training and experience since most of these enterprises are of sole proprietorship business type and they are managed by their owners who might have a little or no managerial skills and experience at all meaning the business is in no room for creativity and innovation hence in risk of being faced out competition and bankruptcy when no financial records are being kept. The government should embark onto this by establishing managerial training centers for small scale entrepreneurs. Due to lack of funds most Small Enterprises are not able to acquire skills on financial management and this affects their operations.

ICT firms in Kiserian Township, Kajiado District of Kenya. From the above local studies, the researchers concentrated on the challenges affecting SMEs in general and though they mentioned financial management practices as a challenge (Dondo, 1991); no notable study has been conducted in Kenya to specifically look at the financial management practices adopted by the SMEs and how they influence their performance. It is against this background therefore that this study seeks to fill this gap by conducting a study to investigate the effect of financial management practices on the financial performance of small and medium enterprises.

1.3 Objective of the Study

The objective of this study was to investigate the effect of financial management practices on the financial performance of small and medium enterprises in Kenya.

1.4 Significance of the Study

The study was expected to be of great value to the following:-

**Banks**

This study would help them understand the impact of lending loans to small enterprises and how to it helps achieve performance success. The study would also help the banks in granting loans and advances to the small enterprises based on their financial records.

**Government**

This study would give insights to the government bodies on how they can form a foundation for helping or enhancing the growth of small enterprises. Moreover, the study would act as a guide to the government on how they can regulate the businesses and enact rules and regulations to guide them. Also in making the national policies, the government would be able to ensure that the tax rates are favorable to these small scale businesses.

**Investors**

Through this study, investors would be able to commit their capital rest assured to gain financial returns. Through this study, they would be able to endow with an enveloping or pervasive quality.
Researchers/ academicians

The study would be a source of reference material for future researchers on other related topics; it will also help other academicians who undertake the same topic in their studies. The results of this study shall be used by academics to discuss the assessment of financial management practices for small enterprises.

The study also highlighted other important relationships that require further research; this may be in the areas of factors affecting small enterprises.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction
This chapter discusses the theoretical review, empirical review and the conceptualization of variables in relation to the study assessment of the financial management practices by small enterprises in Kenya.

2.2 Theoretical Review

2.2.1 The Pecking-Order Theory or Framework (POF)
This is another financial theory, which is to be considered in relation to SMEs financial management. It is a finance theory which suggests that management prefers to finance first from retained earnings, then with debt, followed by hybrid forms of finance such as convertible loans, and last of all by using externally issued equity; with bankruptcy costs, agency costs, and information asymmetries playing little role in affecting the capital structure policy. A research study carried out by Norton (1991b) found out that 75% of the small enterprises used seemed to make financial structure decisions within a hierarchical or pecking order framework. Holmes et al. (1991) admitted that POF is consistent with small business sectors because they are owner-managed and do not want to dilute their ownership. Owner-managed businesses usually prefer retained profits because they want to maintain the control of assets and business operations.

The 1971 Bolton report on small firms outlined issues underlying the concept of 'finance gap' (this has two components-knowledge gap-debt is restricted due to lack of awareness of appropriate sources, advantages and disadvantages of finance; and supply gap-unavailability of funds or cost of debt to small enterprises exceeds the cost of debt for larger enterprises.) that: there are a set of difficulties which face a small company. Small companies are hit harder by taxation, face higher investigation costs for loans, are generally less well informed of sources of finance and are less able to satisfy loan requirements. Small firms have limited access to the capital and money markets and therefore suffer from chronic undercapitalization. As a result;
they are likely to have excessive recourse to expensive funds which act as a brake on their economic.

Costand et al (1990) suggests that 'larger firms will use greater levels of debt financing than small firms. This implies that larger firms will rely relatively less on equity financing than do smaller firms'. According to the pecking order framework, the small enterprises have two problems when it comes to equity funding McMahon et al. (1993). Small enterprises usually do not have the option of issuing additional equity to the public; 2). Owner-managers are strongly averse to any dilution of their ownership interest and control. This way they are unlike the managers of large concerns who usually have only a limited degree of control and limited, if any, ownership interest, and are therefore prepared to recognize a broader range of funding options. Modern financial management is not the ultimate answer to every whim and caprice. However, it could be argued that there is some food for thought for SMEs concerning every concept. For example Access to Capital and POF are really eye-openers for SMEs to carve their way into sustaining their growth.

2.2.2 Agency Theory

Agency theory argues that in the modern corporation, in which share ownership is widely held, managerial actions depart from those required to maximize shareholder returns (Pratt and Zeckhauser 1985). In agency theory terms, the owners are principals and the managers are agents and there is an agency loss which is the extent to which returns to the residual claimants, the owners, and fall below what they would be if the principals, the owners, exercised direct control of the corporation (Jensen and Meckling 1976). Agency theory specifies mechanisms which reduce agency loss (Eisenhardt 1989). These include incentive schemes for managers which reward them financially for maximizing shareholder interests. Such schemes typically include plans whereby senior executives obtain shares, perhaps at a reduced price, thus aligning financial interests of executives with those of shareholders (Jensen and Meckling 1976).

Other similar schemes tie executive compensation and levels of benefits to shareholders returns and have part of executive compensation deferred to the future to reward long-run value maximization of the corporation and deter short-run executive action which harms corporate
value. Organizational economics is concerned to forestall managerial “opportunistic behaviour” which includes shirking and indulging in excessive perquisites at the expense of shareholder interests (Williamson 1986). A major structural mechanism to curtail such managerial “opportunism” is the board of directors. This body provides a monitoring of managerial actions on behalf of shareholders. Agency and organizational economics theories predict that when the CEO also holds the dual role of chair, then the interests of the owners will be sacrificed to a degree in favour of management, that is, there will be managerial opportunism and agency loss.

The model of man underlying agency and organizational economics is that of the self-interested actor rationally maximizing their own personal economic gain. The model is individualistic and is predicated upon the notion of an in-built conflict of interest between owner and manager. Moreover, the model is one of an individual calculating likely costs and benefits, and thus seeking to attain rewards and avoid punishment, especially financial ones. This is a model of the type called Theory X by organizational psychologists (McGregor 1960). There are, however, other models of man which originate in organizational psychology and organizational sociology. Organizational role-holders are conceived as being motivated by a need to achieve, to gain intrinsic satisfaction through successfully performing inherently challenging work, to exercise responsibility and authority, and thereby to gain recognition from peers and bosses (McClelland 1961). Thus, there are non-financial motivators.

Managers with the corporation, especially like if they have served there with long tenure and have shaped its form and directions, promotes a merging of individual ego and the corporation, thus melding individual self-esteem with corporate prestige. Again, even where a manager may calculate that a course of action is unrewarding personally they may nevertheless carry it out from a sense of duty, that is, normatively induced compliance (Etzioni 1975). Agency theorists posit a clear separation of interests between managers and owners at the objective level (Jensen and Meckling 1976), this may be debatable, and organizational sociologists would point out that what motivates individual calculative action by managers is their personal perception (Silverman 1970). To the degree that an executive feels their future fortunes are bound to their current corporate employers through an expectation of future employment or pension rights, then the
individual executive may perceive their interest as aligned with that of the corporation and its owners, even in the absence of any shareholding by that executive.

2.2.3. Trade off Theory

This a theory of balance between the deadweight costs of bankruptcy and the tax shield benefits derived from debt – emerged following criticism leveled at Modigliani and Miller's theorem. The new variables introduced in theory included: corporate income tax, interest expense deductions, and costs of financial distress (bankruptcy costs). The theory emphasized the role of tax shield benefits arising from debt financing. An increase in leverage, under circumstances in which the firm is unable to take advantage of interest expense deductions may cancel out the tax shield benefit.

On the other hand, firms with a higher level of leverage are more exposed to the risk of financial distress (i.e. bankruptcy risk); up to a certain debt ceiling, such risks remain negligible, yet further leverage may considerably increase risk; the cost of financial distress consists in the losses incurred by a firm which was declared bankrupt or faces major challenges such as declining sales, reduced output capacity or asset sell-offs below book value; such situations involve, on the one hand, direct costs (legal and administrative expenses, wearing out and obsolescence), and on the other, indirect expenses (ineffective management actions and effects of investors’, suppliers’ and citizens’ attitude); in order to rescue the firm, the decisions made have only a short-term positive impact (asset sales below their book value – to raise cash; cutting production expenses disregarding the implications on the quality of products); in the long term, such decisions lead to a decline in the market value of the firm.

The classical version of trade-off theory was formulated by Kraus & Litzenberger (1973); it states that the optimal leverage level reflects a trade-off between the tax shield benefits of debt and the bankruptcy costs. The two proponents of the theory showed that, for a specific period (one year, for instance), the market value of a levered firm is equal to the market value of an unlevered firm, to which is added the present value of the tax shield of debt less the present value of bankruptcy costs.
According to Myers (1984) pointed out that a firm operating under the assumptions of trade-off theory sets a target leverage ratio that it aims to achieve (hence also aiming for a target/optimal financial structure); the target leverage ratio can be determined by balancing the dead-weight costs of bankruptcy with the tax deductions on interest earnings. Further contributions to the development of the theory were made by Scott (1977), who recognizes that higher leverage increases the risk of bankruptcy and financial management distress and argues that the theory is applicable to large firms that are able to generate higher earnings.

The theory postulates that firms increase their leverage up to the point where the utility of an additional unit of debt is equal to the cost of debt, including the costs incurred due to a greater probability of financial distress (linked to rising debt levels). Aggregating the outcomes of research in the field, Frank & Goyal (2005) indicate that the target leverage ratio can be reached in two phases: a) the static trade-off phase during which the firm operates under the assumptions of the trade-off theory for a definite period of time, e.g. one year; b) dynamic trade-off phase which allows successive adjustment steps in order for the firm to gradually move towards the target debt ratio.

2.3 Financial Management Practices

2.3.1 Accounting Information Systems

Regarding the use of financial information, DeThomas and Fredenberger’s (1985) study indicated that 96 percent of the respondents had financial statements prepared, the responsibility for evaluating and using the information was within the business itself and only four percent relied on an outside accountant. For computer software applications in accounting, Raymond and Magnenat-Thalmann (1982) conducted a survey of 129 small manufacturing businesses, whose number of employees totaled between 20 and 250 and sales varied from $0.5 to $ 25 million, in 1982. Another survey of 464 small businesses was carried out by Raymond in 1985 in the province of Quebec. In the 1990’s, Chen (1993) found that accounting still was the most important and widely software in the small business studied.

In the USA, researchers conducted many surveys of the most important applications of computers in accounting. Cheney (1983) reports on a survey of 30 small and medium-sized
businesses in a variety of industries in Georgia. The results revealed that the most important applications of computer software are in the areas such as payroll, accounts receivable, accounts payable and general ledger. In the UK the most significant studies of small enterprises were conducted by Bolton Committee (1971). Additionally, there are several researchers who studied accounting systems such as Corner (1967), Murphy (1978 and 1979). According to McMahon et al. (1993) the inadequacy of financial record keeping system in small enterprises was well documented in the main Bolton Report (1971) and in various supplementary research reports. This situation reflected a poor appreciation of the significance of financial management amongst owner-managers who were often technically-or sales oriented.

Concerned with costing systems, Corner (1967) reported on the results of studies including 119 small enterprises, 62 medium-sized enterprises and 29 large enterprises in 1963. Awareness of use of costing systems was found to be very high in the study of Murphy (1978 and 1979) whereas the utilization of costing systems was lower. Murphy (1978) explained that smaller enterprises were often aware of the importance of sound costing systems but they lacked the time and expertise to install such systems. Lovett (1980) found that many businesses either had no costing system at all or relied on periodic attempts to estimate the cost of a product through a rough calculation of the labor and materials content plus a mark up for overhead and profit.

In Australia Peacock (1985, 1987, and 1988), Williams (1986), and Holmes (1987) are typical researchers who published results of studies of accounting information system practices. Peacock (1985) investigated the effects and causes of more 1,000 proprietary company failures in South Australia during ten years and found that 4.6 percent of failures had inadequate or no accounting records. In another study of company failures in South Australia, Peacock (1987) reviewed the bankruptcy reports of 418 unincorporated businesses for four years and found that 50.5 percent of these used single entry systems, 32.8 percent used bank and taxation records whereas only 2.1 percent utilized double entry systems. In a more recent study, Peacock (1988) found a significant element in the failure of many of the businesses was inefficient or absence of accounting records. More than half of the businesses failed were found to have no records or only basic bank and taxation records. Peacock’s (1985, 1987, and 1988) findings are very important as examining the impact of accounting system practices on performance of SMEs.
Williams (1986) evaluated the adequacy of accounting records for 10,570 failed and surviving small enterprises operating throughout Australia. The accounting system practices of SMEs have long attracted the attention of many researchers.

### 2.3.2 Working Capital Management

Working capital management includes cash management, receivables and payables management, and inventory management. On cash management practices, Grablowsky (1978) and Grablowsky and Rowell (1980) conducted a questionnaire survey concerned with the cash management practices of 66 small enterprises from a number of industries located in and around Norfolk, Virginia. The method employed was to hold cash as a fixed ratio of projected expenses, forecasted sales or anticipated purchases. Non-quantitative methods used consisted of meeting compensating balance requirements, maintaining the level considered safe by management or achieving a level recommended by outside advisers.

Additionally, seventy-one percent of business in the Virginia survey reported that they had no short-term surpluses of cash in their recent history. Only 23 percent had a long-term surplus. Nearly 30 percent of respondents had invested excess cash in earnings securities or accounts. The most common investments were savings accounts, certificates of deposit, treasury bills, repurchase agreements, commercial papers, shares, bonds and other investments. Cooley and Pullen’s (1979) cash management was seen as the process of planning and controlling cash flows. It consisted of three basic components: cash forecasting practices, cash surplus investment practices and cash-control practices.

Cooley and Pullen (1979) examined cash management practices of 122 small businesses engaged in petroleum marketing and reported that 73 percent of respondents had experienced a cash surplus. In contrast to Grablowsky and Rowell’s (1980) and Cooley and Pullen’s (1979) survey, Murphy’s (1978) study indicated that active cash management in small enterprises in the UK was unusual, and that there was little inclination to invest surplus cash on a short-term basis. Generally, 53 percent of the sample businesses indicated that they prepared cash forecasts, substantially higher than the 30 percent figure reported by Grablowsky (1978, 1980). Regarding
accounts receivable management practices, Grablowsky (1976) and Grablowsky and Rowell (1980) found generally low standards. Approximately 95 percent of businesses that sold on credit tended to sell to anyone who wished to buy. Only 30 percent of respondents subscribed to a regular credit reporting service. Most had no credit checking procedures and guidelines, and only 52 percent enforced a late-payment charge. Thirty-four percent of businesses had no formal procedure for aging accounts receivable. Bad debts averaged 1.75 percent of sales, with a high of 10 percent in some concerns.

Murphy (1978) revealed a very high level of awareness and utilization of credit control systems in the UK, even in the smallest businesses. On inventory management practices, D’Amboise and Gasse (1980) studied the utilization of management techniques in small shoe and plastic manufacturing industries in Canada and found 64 percent of shoe and 65.4 percent of plastic businesses employed formal inventory control systems. While Grablowsky and Rowell (1980) found that most of the respondents had in excess of 30 percent of their capital invested in inventory, the general standard of inventory management was poor. Only six percent of businesses in their survey used a quantitative technique such as economic order quantity for optimizing inventory and 54 percent had systems which were unable to provide information on inventory turnover, reorder points, ordering costs or carrying costs. Related to the methods used to determine inventory level, Grablowsky (1976) compared methods used by a sample of 94 small enterprises with those used by large enterprises working capital management practices have long attracted the attention.

2.3.3 Capital Structure

A firm’s capital structure refers to the mix of its financial liabilities. As financial capital is an uncertain but critical resource for all firms, suppliers of finance are able to exert control over firms (Myers 1984). Debt and equity are the two major classes of liabilities, with debt holders and equity holders representing the two types of investors in the firm. Each of these is associated with different levels of risk, benefits, and control. While debt holders exert lower control, they earn a fixed rate of return and are protected by contractual obligations with respect to their investment. Equity holders are the residual claimants, bearing most of the risk, and, correspondingly, have greater control over decisions.
Capital structure has proved to be a perennial puzzle in finance (Myers 1984). The original M and M propositions (Modigliani and Miller, 1958 and 1963) highlighted the important issues involved in financial structure decisions namely: the cheaper cost of debt compared to equity; the increase in risk and in the cost of equity as debt increases; and the benefit of the tax deductibility of debt. They argued that, in the absence of taxes, the cost of capital remained constant as the benefits of using cheaper debt were exactly offset by the increase in the cost of equity due to increased risk. With taxes and the deductibility of interest charges they concluded that firms should use as much debt as possible. Myers (1984) described the compromise static trade-off theory in which firms would use a good deal of debt to take advantage of tax deductibility but not too much to avoid the increasing likelihood of costly bankruptcy.

In practice there is considerable variation in the use of debt. This is particularly apparent for SMEs, with survey results (e.g. Ray and Hutchinson, 1983) showing that many SMEs do not use any debt and very few use any external equity or long-term debt (Bolton, 1971, Wilson, 1980). A response to this has been that this reflects shortcomings on the part of SME owner-managers on the demand side and, or, deficiencies on the part of financial institutions and capital markets (the finance gap) on the supply side. In recent years there have been attempts to provide explanations, of a positive rather than normative nature, of SME financing using agency theory (Jensen and Meckling, 1976).

The determinants of capital structure were specifically considered by Myers (1977). The pecking order theory (POT) as proposed by Myers (1984), provided further explanations as to what determines firms’ capital structures and was built on the work of Jensen and Meckling (1976) on agency theory, of Myers and Majluf (1984) on information asymmetry, and of Ross (1977) on Signaling theory. Myers (1984) extended the work of Donaldson (1961) by applying the term pecking order to Donaldson’s description of firms’ preferences for finance. Myers (1984) contrasted his POT with the static trade-off theory, which had developed from the M&M propositions. The POT argument was that there was no well-defined target equity mix because there were two kinds of equity, one at the top of the pecking order and one at the bottom. Particularly because of the costs caused by information asymmetry in dealing with outsiders, firms would rank internal finance highest. Information asymmetry is part of the “moral hazard”
problem that takes the form of post–contractual opportunism particularly by means of asset substitution (Jensen and Meckling 1976). This is more likely to arise in dealings with small enterprises because of their close nature, i.e. being controlled by one person or a few, related people (Watson and Wilson, 2002) and their having fewer disclosure requirements.

The preference for internally generated funds would then require adjustment of firms’ dividend policy but given that dividends are sticky it could not be guaranteed that internal funds would equal those needed for investment purposes (Adedeji, 1998). Where the funds available were greater than those needed, firms could invest the excess in securities. If funds from retained profits were not enough, firms could draw on their deposits, and if this was still not sufficient they might consider borrowing followed by issuing hybrid securities and finally, by issuing equity. Issuing equity was seen by Myers (1984) as particularly undesirable because of the bad signal it gave to shareholders.

According to Cosh and Hughes (1994), the POT, with its emphasis on the desirability of the use of funds generated within the business rather than funds raised externally, can readily be applied to SMEs. Indeed SMEs seem to face a more extreme version of the POT described as a constrained POT by Holmes and Kent (1991) and a “modified” POT by Ang (1991) because they have less access to external funds, debt as well as equity than do large enterprises. The POT suggests that use of external funds is very much related to profitability on the basis that SMEs, particularly if they are not stock exchange listed, will make use of internally generated funds as a first resort, i.e. those which make use of external funds will be those with a lower level of profit.

Growth is likely to lead SMEs that do not have sufficient internal resources to borrow although if the pecking order is constrained by lack of external funding of any kind, SMEs might restrict their growth to fit the availability of internal funds. Myers (1984) refers to the importance of asset type in providing collateral for borrowing in a situation of information asymmetry. Given the “lumpiness” of many investments, it is more likely that smaller firms will need to borrow than large when faced with investment opportunities. It can also be deduced from the POT, given the importance of retained funds, that newer firms will have less time to accumulate resources and so will need to borrow more than older firms.
2.3.4 Capital Budgeting

Capital budgeting is the whole process of analyzing projects and deciding whether they should be included in the capital budget. This process is of fundamental importance to the success or failure of the firm as the fixed asset investment decisions chart the course of a company for many years into the future. The payback, or payback period, is the number of years it takes a firm to recover its project investment. Payback may be calculated with either raw cash flows (regular payback) or discounted cash flows (discounted payback). In either case, payback does not capture a project’s entire cash flow stream and is thus not the preferred evaluation method. Note, however, that the payback does measure a project’s liquidity, and hence many firms use it as a risk measure (Myers 1984).

According to Cosh and Hughes (1994), Capital budgeting, which can be described as the formulation and financing of long-term plans for investment, is one of the most important responsibilities of the owners/managers of small manufacturing firms. The decisions made during the capital budgeting process determine the future growth and productivity of the firm. Capital budgeting is a process designed to achieve the greatest profitability and cost effectiveness in the private and public sectors of the economy. Capital budgeting and the estimation of the cost of capital (the rate of return that a firm must earn on its investments to ensure that the minimum requirements of the providers of capital are met) are the most important financial decisions facing owners/managers of the small firms.

The need for relevant information and analysis of capital budgeting alternatives has inspired the evolution of a series of methods to assist firms in making the “best” allocation of resources. Amongst the earliest methods available were the non-discounted cash flow methods and the discounted cash flow techniques. The no discounted cash flow methods are form of capital budgeting techniques used in evaluating the uncertainty and risk of the value of a firm without considering the time value of money. These techniques are biased in selecting projects and also do not consider cash flows in investment decisions. The techniques constitute the traditional payback period (PB) and the accounting rate of return (ARR) techniques as thus discussed (Chartered Institute of Management Accountants [CIMA], 2002).
2.3.5 Portfolio Management

The term portfolio refers to any collection of financial assets such as stocks, bonds, and cash. Portfolios may be held by individual investors and or managed by financial professionals, hedge funds, banks and other financial institutions. It is a generally accepted principle that a portfolio is designed according to the investor's risk tolerance, time frame and investment objectives. The monetary value of each asset may influence the risk reward ratio of the portfolio and is referred to as the asset allocation of the portfolio (Cooper, 1998). When determining a proper asset allocation one aims at maximizing the expected return and minimizing the risk. This is an example of a multi-objective optimization problem: more "efficient solutions" are available and the preferred solution must be selected by considering a tradeoff between risk and return. In particular, a portfolio A is dominated by another portfolio A' if A' has a greater expected gain and a lesser risk than A. If no portfolio dominates A, A is a Pareto-optimal portfolio. The set of Pareto-optimal returns and risks is called the Pareto Efficient Frontier for the Markowitz Portfolio selection problem (Cooper, 1997).

According to Evans, (1996), Portfolio Management refers to such activities as financial institutions evaluating the risk/return profile of the credit portfolio and enhancing the soundness and profitability of the portfolio through credit risk transfer transactions. Unlike traditional loan management, Portfolio Management is characterized by the fact that it not only assesses the credit risk and profitability of individual loan assets, but also controls the overall risk return profile of the credit portfolio. In recent years, more and more globally active financial institutions in the US and Europe have been proactively engaged in Portfolio Management, rebalancing their loan asset portfolios while utilizing the credit market's functions to the full. There are also many cases where institutions evaluate credit concentration risk and mitigate it mainly through control of the loan approval process, without involving themselves in active market transactions of this sort.
2.3.6 Dividend Policy

Dividend policy is the core component of a firm’s overall financial policy. It is comprised of a series of decisions regarding how the firms distribute profits to their shareholders and it mostly includes basic contents about the selection of dividend policy, dividend payout ratio and payout channel etc. Since the dividend policy determines whether distribute the earnings to shareholders or self-finance through retained earnings, so it is an important issue that receives more attention these days from both academics and practitioners (Li et al., 2006). Corporate income tax is one of the major sources of revenue to all governments. In Nigeria, it is a factor to be reckoned with in Federal Government’s budget. The taxes so collected come back to the taxpayers in form of services and to either encouraged or discouraged some activities in the private sector; though, this depends on whether the policy of the government is towards discouraging or encouraging such companies (Ola, 1999).

Dividends are usually paid to owners or shareholders of business at specific periods. This is apparently based on the declared earning of the company and the recommendations made by its directors. Thus, if there are no profits made, dividends are not declared. But when profits are made, the company is obligated to pay corporate tax including other statutory taxes to the government. This is an essential corporate responsibility particularly profit making companies. The taxes no doubt reduce the profits available at the disposal of the organizations, either to be retained or distributed as a dividend to shareholders of the company. Dividend policy is the trade-off between retaining earning and paying out cash or issuing new shares to shareholders. Some firms may have low dividend payout because management is optimistic about the firm’s future and therefore wishes to retain their earnings for further expansion. Frankfurter and Wood (1997) indicate, dividend pattern of a firm is a cultural phenomenon that changes continuously in relation to environment and time. It is hard to deny that taxes are important to investors.

2.3.7 Risk Management

Small and medium enterprises (SMEs) operate in the same environment as their larger counterparts, but without the associated benefits such as adequate capital and extended human resources of the larger organizations. SMEs encounter increasing competitive pressure fuelled by
globalization, legislation and the relaxing of trade barriers, as well as an increase in market expansion due to emerging technologies and innovation. Small and medium enterprises often flourish on their adaptability and agility such as their close proximity to their customers, their openness towards new ways of working, and their risk taking approach, but many micro, small and medium enterprise are susceptible to major external shocks (Berry, 2002; Laforet and Tann, 2006).

According to Plourd (2009), the importance of risk management is now escalated above issues such as long-term and short-term financing constrains. Proclaiming the existence of a risk management strategy is insufficient, enterprises need to actively engage in risk management practices to address the convergence of major risks as experienced in the current economic climate where the credit crisis risk, fluctuating commodity prices, increased government debt, rising unemployment and declining consumer spending are impacting individually and combined, on enterprises. The use of enterprise risk management (ERM) can be viewed as a business competency enabling managers to optimize opportunities associated with risks (Hofmann, 2009). ERM should apply basic risk management activities, embedding the risk champion’s knowledge of exposures, across the entire scope of an enterprise’s risks such as strategic risks, operational risks, financial risks and regulatory compliance risks (Engle, 2009), and should not be reduced to a process based solely on risk formula’s. A structured risk management approach enables an enterprise to pursue its strategies aggressively and efficiently as management can anticipate the risk exposure of each activity engaged in, thus achieving more acceptable results at a reduced cost.

Risk and risk management is a major concern for all companies, especially small and medium sized enterprises which are particularly sensitive to business risk and competition. In SMEs, the risk management function usually resides with the owner’s assessment of threats and opportunities pertaining to the enterprise (Watt, 2007). Although risk management principles are common to all types of enterprises, the owner-manager’s risk perception and his Smit and Watkins 6327 attitude towards risk management influences the adequacy of the enterprise’s risk management actions deployed (Ntlhane, 1995). Implied in SME, risk management is the core principle that entrepreneurial or management focus should be focused at recognizing future
uncertainty, deliberating risks, possible manifestations and effects, and formulating plans to address these risks and reduce or eliminate its impact on the enterprise (Ntlhane, 1995). One of the skills required of entrepreneurs is the ability to identify and analyze risks to ensure that advantage is taken of calculated risks (Watson, 2004).

### 2.4 Empirical Review

Financial management emerged as a separate discipline at the turn of the 20th century. In the evolutionary stage, its focus was mainly on certain more important events like formation of a business firm; issue of capital, merger, expansions etc. and the approach towards financial management was outside looking. In the traditional phase (early 1940s) greater emphasis was placed on the day-to-day problems encountered by financial managers and the focus was on working capital management, financial analysis, planning and control of the financial management. The modern phase of the financial management which began in the mid 1950”s witnessed significant developments in terms of theory, concepts, financial products, and quantitative methods of analysis. The main concern of modern phase of financial management is to maximize the wealth of current shareholders by a judicious matching of funds to their uses.

The advent of liberalization, globalization and privatization of economy since 1991, has brought in several challenges, threats and opportunities before the managers of business enterprises. Investment opportunities have expanded, competition has heightened, financing options have widened and, above all, dependence on capital market has increased. In emerging business environment, it is essential for finance managers of various firms to appraise and review the prevailing financial policies so as to identify the major issues requiring immediate attention. The modern-day finance manager is instrumental to a company’s success.

In broader sense his functions today includes (i) to identify, evaluate, and implement investment projects (capital budgeting decision); (ii) determining the best financial mix (capital structure decision); (iii) decide percentage of earnings to be paid to stock holders in cash dividend and stock dividend (dividend decision); and (iv) short terms financial management ( known as working capital management). The corporate managers have to take new and bold initiatives to make deserving changes in their financial goals, policies, procedure and other such aspects. In
this paper, an attempt is made to analyze financial management practices with reference to service industry excluding banks and financial institution (Krishnamurty and Sastry, 1971).

One of the major decisions of the finance managers of a firm is financing decision. In this decision the finance manager is concerned with determining the best financing mix or capital structure. A firm may decide to finance its investment requirements through either equity only or through debt only or a mixture of both. Normally a firm follows the third option. Consequently, the balance sheet of the firm contains both equity and debt as sources of funds. The challenge before the economists or the researchers in finance is to determine the optimal mix of equity and debt that a firm should ideally have. Dividend decision is another major function of the finance managers. A few studies have analyzed the dividend behavior of corporate firms (Mahapatra and Sahu, 1993).

2.5 Conclusion

Findings from studies done earlier and government reports on the state of affairs of small scale enterprises reveals that the sector faces numerous problems and constrains that affect financial management practices. While much research has been done on the small business, none has been done specifically in financial management practices of the financial performance by SMEs in Kenya. The overall problem therefore is that relatively little is known about management practices faced
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methodology that was used to collect data for the study. It covered the research design, the target population, sample of the population, data collection instruments and procedures.

3.2. Research Design

Research design refers to the strategy used by the researcher in collecting and analyzing data. According to Cooper and Schindler (2003), a descriptive study is concerned with finding out the what, where and how of a phenomenon. Descriptive research design was chosen because it enabled the researcher to generalise the findings to a larger population. The design was deemed appropriate because the main interest established financial management practices affecting top one hundred SMEs in Kenya more specifically the SMES within Nairobi area.

Descriptive design method provided quantitative data from cross section of the chosen population. The visit to population of interest was done to administer questionnaires which were used to collect necessary data from the respondents. According to Mugenda and Mugenda (2003) the descriptive research collected data in order to answer questions concerning the current status of the subject under study

3.3 Population

A population is defined as the total collection of elements about which we wish to make some inferences (Cooper and Schindler, 2003). According to Cooper and Schindler (2003), a population element is the subject such as a person an organization, customer database, or the amount of quantitative data on which the measurement is being taken.
According to Ngechu (2004), a population is a well defined or set of people, services, elements, events, group of things or households that are being investigated. This definition ensures that population of interest is homogeneous. Population studies are more representative because everyone has equal chance to be included in the final sample that is drawn according to Mugenda and Mugenda (2003). The target population for this study targeted all the registered SMEs within Nairobi area. 520 respondents was the target population.

3.4 Sample and Sampling Technique

A sample refers to a section of the population that has been selected for observation and analysis. The essential requirement of any sample is that it has to be as representative as possible of the population from which it is drawn. From the above population of 520 possible respondents, a sample of 10% was used. Fifty two respondents were selected representing a population of 520 possible respondents using Stratified random sampling by taking 10% of the target population in each stratum.

3.5 Data Collection Instruments

The researcher used a questionnaire as the primary data collection instrument. The questionnaire was designed to give a brief introduction of SMEs. The questionnaire was divided into sections representing the various variables adopted for study. For each section of the chosen study included closed structured and open ended questions which collected the views, opinion, and attitude from the respondent which was not be captured by the researcher. The questionnaire administered through drop and pick method to the top managers working in the SMES.

The questions were designed to collect qualitative and quantitative data. The open ended questionnaires gave unrestricted freedom of answer to respondents. The researcher used assistants to distribute by hand the questionnaires to be completed by the selected respondents. Upon completion, the research assistants collected the questionnaires and ensure high completion rate and return of the completed questionnaires. The researcher used drop and pick method so as to give the respondents enough time as possible to fill the questionnaire.
3.6 Validity and Reliability of Research Instrument

Validity involve how accurately the data obtained represents the variables of the study while reliability refers to the degree to which a research instrument yields consistent results or data after repeated trials to establish its reliability (Saunders, et.al., 2003). Validity of the instrument will be established by the research supervisor reviewing the items. To ensure reliability, the questionnaires were pre-tested on a pilot scale through selected respondents outside the study area. The objectives of pre-testing were to allow for modification of various questions in order to rephrase, clarify and or clear up any shortcomings in the questionnaires before administering them to the actual respondents.

3.7 Data Analysis and Presentation

This included the analysis of data to summarize the essential features and relationships of data in order to generalise from the analysis to determine patterns of behaviour and particular outcomes. Before processing the responses, the completed questionnaires were edited for completeness and consistency. Content analysis and descriptive analysis were employed. The content analysis was used to analyze the respondents’ views about the financial management practices faced by SMEs in Kenya. The data was then coded to enable the responses to be grouped into various categories.

Data was then grouped into frequency distribution to indicate variable values and number of occurrences in terms of frequency. Frequency distribution table was informative to summarize the data from respondents, percentages and other diagrams such as bar charts, histogram, grouped frequency distributions and pie charts were used during the analysis. The organised data was interpreted on account of concurrence and standard deviation to objectives using assistance of computer packages especially SPSS version to communicate research findings. Tables and other graphical presentations as appropriate were used to present the data collected for ease of understanding and analysis. The study adopted regression model to show the variable. It used the model below:
The regression equation used was;

\[ Y = a + B_1 X_1 + B X_2 + B_3 X_3 + \ldots + B_n X_n + \epsilon \]

Where: \( Y \) = Dependent Variable (financial performance) - Measured through profits (Sales Volume – Expenses).

\( X_i \) = Independent variables

- \( X_1 \) = Accounting Information Systems
- \( X_2 \) = Working Capital Management
- \( X_3 \) = Capital Structure
- \( X_4 \) = Capital Budgeting
- \( X_5 \) = Portfolio Management
- \( X_6 \) = Divided Policy
- \( X_7 \) = Risk Management

\( a \) = the constant

\( \epsilon \) = error term
4.1 Introduction

This chapter presents analysis and findings of the study based on data collected from the field. The analysis was focused on answering the research questions. The results are presented on the effect of financial management practices on the financial performance of small and medium Enterprises in Kenya. The data was gathered exclusively from questionnaire as the research instrument. The questionnaire was designed in line with the objectives of the study.

4.2 Data Presentation

4.2.1 Response Rate

Table 4:1: Response Rate

<table>
<thead>
<tr>
<th>Response</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Responded</td>
<td>35</td>
<td>67</td>
</tr>
<tr>
<td>Not responded</td>
<td>17</td>
<td>33</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: Survey Data, 2012

The study targeted to sample 52 respondents in collecting data with regard to the effect of financial management practices on the financial performance of small and medium Enterprises in Kenya. From the study, 30 out of 52 sampled respondents filled in and returned the questionnaire contributing to 58%. This commendable response rate was made a reality after the researcher made personal visits to remind the respondent to fill-in and return the questionnaires.
4.2.2 Demographic Information

The demographic information was to determine the gender, age group, level of education and the total number of employees in the organizations. These were important because they indicated the basic understanding of the effect of financial management practices on the financial performance of small and medium Enterprises in Kenya.

4.2.2.1 Gender of the Respondents

On the gender of the respondents, the study found that there were more males shown by 70% and females were 30% of the respondents.

4.2.2.2 Age Distribution of the Respondents

The study also sought to establish the respondents’ age bracket. From the findings, the majority of the respondents were 30-35 years old as shown by 26% of the respondents and 20% were aged 26-30 years, 36-40 years were represented by 16%, 21-25 years by 13%, 40-50 years indicated by 10%, below 20 years represented by 8% and above 50 years had a percentage of 7% as shown in the graph below.

![Age distribution graph]

Figure 4.1 Age distribution

Source: Survey Data, 2012
4.2.2.3 Level of Education

Table 4.2 Education level

<table>
<thead>
<tr>
<th>Education level</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secondary</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td>Diploma</td>
<td>20</td>
<td>57</td>
</tr>
<tr>
<td>First degree</td>
<td>10</td>
<td>28</td>
</tr>
<tr>
<td>Post graduate</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>35</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: Survey Data, 2012

From the table above it was disclosed that the majority were Diploma graduates by 57%, followed by 28% first degree graduates, secondary level were represented by 9% and the least percentage were post graduate level indicated by 6%.

4.2.2.4 Total number of the employees in your organization

Table 4.3 Total number of the employees in your organization

<table>
<thead>
<tr>
<th>Numbers</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 50</td>
<td>20</td>
<td>57</td>
</tr>
<tr>
<td>50-100</td>
<td>6</td>
<td>17</td>
</tr>
<tr>
<td>Above 100</td>
<td>9</td>
<td>26</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>35</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: Survey Data, 2012

The study sought to investigate the number of employees in the organization. From the results, 57% of the respondents worked in the organization of less than 50 employees, 17% of them
worked in the organization consisting of 50-100 employees, while 26% of the respondents indicated that they worked in the organization of above 100 employees.

4.2.3 Accounting Information Fundamentals

The study sought to find out how the accounting information has fundamentally changed the way the SMEs conduct their businesses. From the study the respondents indicated that cash management has enabled the organizations to better their services to their clients focusing more towards value added services. The study found out that the organizations’ firm size provides financial resources to acquire a new technology and enable spending on innovative activities.

4.2.4 Financial Management Practices

The study sought to investigate some of the financial management practices used in the companies. From the respondents it was found out that delegation of decision making authority is one of the financial management practices used in the companies. The study also found out that developing the economies was another financial management practices. Capital budgeting, planning and control were also some of the financial management practices that were used in the companies as indicated by the respondents.

4.2.5 Computer Software Applications

The study sought to find out some of the computer software that the company is using. From the findings it was indicated that budgeting helps to set spending limits and manage the cash flow. Banking which helps in paying bills electronically on time, print checks and reconcile account balances. Planning to monitor and pay down debt, estimate major life expenses, forecast retirement needs, and run calculations. Investing to help get the stock quotes and track your portfolios.

4.2.6 Financial record keeping system

The study sought to find out whether there was inadequacy of financial record keeping system in the company. From the findings it was indicated that 77% of the respondents agreed to the fact that there was inadequate financial record keeping while 23% of the respondents opposed to the fact that there was inadequate financial record keeping.
Figure 4.2 Financial record keeping systems

Source: Survey Data, 2012

4.2.7 Agreement on Accounting Information

Table 4.4 Agreement on accounting information

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>Std Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting technology has enabled the globalization of the economy and facilitated competition</td>
<td>2.5082</td>
<td>1.73803</td>
</tr>
<tr>
<td>It has subsequently brought about large scale change in the industrial nations</td>
<td>2.3607</td>
<td>1.51694</td>
</tr>
<tr>
<td>There is rapid growth of some industries such as computer, communications software and financial services</td>
<td>2.6885</td>
<td>1.80315</td>
</tr>
<tr>
<td>It has created new services and enhancing efficiencies</td>
<td>2.3607</td>
<td>1.71302</td>
</tr>
<tr>
<td>Traditional industries have stalled or even contracted in comparison</td>
<td>2.3934</td>
<td>1.63584</td>
</tr>
</tbody>
</table>

| Total                       | 12.3115 | 8.40698   |
| Average                     | 2.4623  | 1.681396  |

Source: Survey Data, 2012

The study sought the respondents’ level of agreement with various statements that related to the
extent which accounting information services affects the growth of SMEs. Majority of the respondents agreed that accessing accounting technology has over the years subsequently brought about large scale change in the industrial nations as shown by a mean score 2.3607, it has created new services and enhancing efficiencies as shown by a mean score 2.3607, traditional industries have stalled or even contracted in comparison as shown by a mean score 2.3934, accounting technology has enabled the globalization of the economy and facilitated competition 2.5082, there is rapid growth of some industries such as computer, communications software and financial services as shown by a mean score 2.6885, and it has also helped in transforming the landscape, accounting is enabling a major shift in the job as shown by a mean score 2.7049.

4.2.8 Working Capital Management

The study sought to find out some of the working capital used in the company. From the findings it was indicated that inventory, accounts receivable, accounts payable are some of the working capitals that the company uses to manage the business. It was also found out that one of the significant uses of the working capital in the company was inventory which keeps the company running.

Table 4.5 Agreement on working capital management

<table>
<thead>
<tr>
<th>Statements</th>
<th>Mean</th>
<th>Std dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMEs should have common investments</td>
<td>2.0820</td>
<td>1.58425</td>
</tr>
<tr>
<td>SMEs should realize importance of cash management in the process of planning and controlling cash flows.</td>
<td>2.4262</td>
<td>1.64782</td>
</tr>
<tr>
<td>Business employed formal inventory control systems</td>
<td>2.0656</td>
<td>1.50409</td>
</tr>
<tr>
<td>SMEs use inventory management practices in capital management</td>
<td>2.2131</td>
<td>1.29248</td>
</tr>
<tr>
<td>Do SMEs use quantitative technique when doing survey</td>
<td>2.3279</td>
<td>1.35057</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11.1148</strong></td>
<td><strong>7.37921</strong></td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>2.22296</strong></td>
<td><strong>1.475842</strong></td>
</tr>
</tbody>
</table>

Source: Survey Data, 2012
The study further sought to establish the extent of agreement with statements related to working capital management. From the study, majority of the respondents were in agreement that business employed formal inventory control systems as shown by a mean score of 2.0656, SMEs should have common investments as shown by a mean score of 2.0820, SMEs use inventory management practices in capital management as shown by a mean score of 2.2131, Do SMEs use quantitative technique when doing survey as shown by a mean score of 2.3279 and SMEs should realize importance of cash management in the process of planning and controlling cash flows as shown by a mean score of 2.4262.

4.2.9 Aspects to Be Considered By Each SME in the Market

Table 4.6 Aspects to be considered by each SME in the market

<table>
<thead>
<tr>
<th>Statements</th>
<th>Mean</th>
<th>Std Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduced inventory</td>
<td>2.1148</td>
<td>1.48434</td>
</tr>
<tr>
<td>Develop just-in-time (JIT) systems</td>
<td>1.7869</td>
<td>.96807</td>
</tr>
<tr>
<td>Pressure to increase quality</td>
<td>1.7541</td>
<td>1.13513</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2.1148</strong></td>
<td><strong>1.48434</strong></td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>1.7869</strong></td>
<td><strong>0.96807</strong></td>
</tr>
</tbody>
</table>

**Source: Survey Data, 2012**

The study sought to investigate the extent to which the firm face financial challenges that affect its growth. From the study, majority of the respondents indicated that pressure to increase quality affects the market to a great extent as shown by a mean score of 1.7541, developing just-in-time (JIT) systems as shown by a mean score of 1.7869, reduced inventory as shown by a mean score of 2.1148, decrease time to market as shown by a mean score of 2.1148.
4.2.10 Financial Management Practices of Financial Performance Used In the Company

Table 4.7 Financial management practices of financial performance used in the company

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting information systems</td>
<td>3.0000</td>
<td>1.50555</td>
</tr>
<tr>
<td>Working capital management</td>
<td>2.9016</td>
<td>1.56743</td>
</tr>
<tr>
<td>Capital structure</td>
<td>1.1967</td>
<td>1.44706</td>
</tr>
<tr>
<td>Capital budgeting</td>
<td>2.5738</td>
<td>1.55412</td>
</tr>
<tr>
<td>Portfolio management</td>
<td>3.0492</td>
<td>1.75524</td>
</tr>
<tr>
<td>Divided</td>
<td>4.0333</td>
<td>5.61163</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>19.7546</strong></td>
<td><strong>14.89017</strong></td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>2.822086</strong></td>
<td><strong>2.127167</strong></td>
</tr>
</tbody>
</table>

Source: Survey Data, 2012

On the extent that the financial management practices of financial performance used in the company majority of the respondents indicated that capital structure to a very great extent as shown by a mean score of 1.1967 and capital budgeting to a great extent as shown by a mean score of 2.5738. Further, they apply to a moderate extent working capital management as shown by a mean score of 2.9016, accounting information systems as shown by a mean score of 3.0000, risk management as shown by a mean score of 3.0000. However, most of the respondents indicated that they apply dividend to a little extent as shown by a mean score of 4.0333.

4.2.11 Regression Model

In the regression analysis, Y (Financial performance) was measured through profits of the SMEs sampled; that is, sales Volume less expense, as shown in appendix III.
Table 4.8 Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.869(a)</td>
<td>0.755</td>
<td>0.651</td>
<td>0.42832</td>
</tr>
</tbody>
</table>

a Predictors: (Constant), accounting information systems, working capital management, capital structure, capital budgeting, portfolio management, divided policy and risk management

Adjusted $R^2$ is called the coefficient of determination and tells us how financial performance varied with accounting information systems, working capital management, capital structure, capital budgeting, portfolio management, divided policy and risk management. From the table above, the value of adjusted $R^2$ is 0.651. This implies that, there was a variation of 65.1% of financial performance with independent variables (accounting information systems, working capital management, capital structure, capital budgeting, portfolio management, divided policy and risk management).

Table 4.9 ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>22.575</td>
<td>7</td>
<td>3.225</td>
<td>4.541</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>6.264</td>
<td>27</td>
<td>0.232</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>28.839</td>
<td>34</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a Predictors: (Constant), accounting information systems, working capital management, capital structure, capital budgeting, portfolio management, divided policy and risk management

b Dependent Variable: Financial performance

The study used ANOVA to establish the significance of the regression model from which an f-significance value of $p<0.001$ was established. This shows that the regression model has a less than 0.001 likelihood (probability) of giving a wrong prediction.
Table 4.10 Coefficients Results

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>0.116</td>
<td>.186</td>
<td>.623</td>
</tr>
<tr>
<td></td>
<td>Accounting information systems</td>
<td>0.577</td>
<td>.068</td>
<td>0.559</td>
</tr>
<tr>
<td></td>
<td>Working capital management</td>
<td>0.157</td>
<td>.043</td>
<td>0.257</td>
</tr>
<tr>
<td></td>
<td>Capital structure</td>
<td>0.052</td>
<td>.024</td>
<td>0.139</td>
</tr>
<tr>
<td></td>
<td>Capital budgeting</td>
<td>0.008</td>
<td>.001</td>
<td>0.505</td>
</tr>
<tr>
<td></td>
<td>Portfolio management</td>
<td>0.103</td>
<td>0.056</td>
<td>0.533</td>
</tr>
<tr>
<td></td>
<td>Divided policy</td>
<td>0.153</td>
<td>0.063</td>
<td>0.748</td>
</tr>
<tr>
<td></td>
<td>Risk management</td>
<td>0.399</td>
<td>0.273</td>
<td>0.246</td>
</tr>
</tbody>
</table>

A Dependent Variable: Financial performance

The following regression analysis was obtained:

\[ Y = 0.116 + 0.577X_1 + 0.157X_2 + 0.052X_3 + 0.008X_4 + 0.103X_5 + 0.153X_6 + 0.399X_7 \]

Whereby \( Y \) is financial performance, \( X_1 \) is accounting information systems, \( X_2 \) is working capital management, \( X_3 \) is capital structure, \( X_4 \) is capital budgeting, \( X_5 \) is portfolio management, \( X_6 \) is divided policy and \( X_7 \) is risk management. The model illustrates that when all variables are held at zero (constant), the value of financial performance would be 0.116. However, holding other factors constant, a unit increase in accounting information systems would lead to a 0.577 increase in financial performance, a unit increase in working capital management would lead to a 0.157 increase in financial performance, a unit increase in capital structure would lead to a 0.052 increase in financial performance, a unit increase in capital budgeting would lead to a 0.008 increase in financial performance, a unit increase in portfolio management would lead to a 0.103 increase in financial performance, a unit increase in divided policy would lead to a 0.153 increase in financial performance and a unit increase in risk management would lead to a 0.399 increase in financial performance.
There was a positive significant relation between financial performance and accounting information systems \( (p=0.000) \), working capital management \( (p=0.000) \), Capital structure \( (p=0.38) \), Capital budgeting \( (p=0.000) \) and risk management \( (p=0.041) \).

**4.3 Summary and Interpretations of Findings**

The research findings revealed that there was gender disparity which has been experienced in many companies since the majority was male. It was also disclosed that majority of the respondents were between 30-35 years. On the aspect of education level of the respondents, it was found out that the majority were in the diploma level. The study also found from the accounting information that cash management has enabled the organizations to better their services to their clients focusing more towards value added services. It was also found out that the organizations’ firm size provides financial resources to acquire a new technology and enable spending on innovative activities.

The study found that that from the financial management practices that delegation of decision making authority is one of the financial management practices used in the companies. The study also found out that developing the economies was another financial management practices. Capital budgeting, planning and control were also some of the financial management practices that were used in the companies as indicated by the respondents. The study found that majority of the respondents had agreed to the fact that there was inadequate financial record keeping at the company. Further, accessing accounting information services has over the years been greatly enhanced with the accounting technology that has enabled the globalization of the economy and facilitated competition; it has subsequently brought about large scale change in the industrial nations, occurrences of rapid growth of some industries such as computer, communications software and financial services, new services have been created and has enhanced efficiencies, traditional industries have also stalled.

On working capital management, the study found that it was indicated that inventory, accounts receivable, accounts payable are some of the working capitals that the company uses to manage the business. It was also found out that one of the significant uses of the working capital in the company was inventory which keeps the company running. From the study, majority of the
respondents were in agreement that business employed formal inventory control systems, SMEs should have common investments. The companies use inventory management practices in capital management and SMEs should realize importance of cash management in the process of planning and controlling cash flows. The study found that majority of the respondents indicated that pressure to increase quality affects the market to a great extent as, developing just-in-time (JIT) systems, reduced inventory, decrease time to market are some of the challenges which the firm faces financially that affect its growth. It was found that that capital structure and capital budgeting affect the financial management practices of financial performance used in the company. Majority of the respondents also indicated that they apply to a moderate extent working capital management, accounting information systems, risk management.

The regression model found that where Y is financial performance, X₁ is accounting information systems, X₂ is working capital management, X₃ is capital structure, X₄ is capital budgeting, X₅ is portfolio management, X₆ is divided policy and X₇ is risk management. The model illustrates that when all variables are held at zero (constant), the value of financial performance would be 0.116. However, holding other factors constant, a unit increase in accounting information systems would lead to a 0.577 increase in financial performance, a unit increase in working capital management would lead to a 0.157 increase in financial performance, a unit increase in capital structure would lead to a 0.052 increase in financial performance, a unit increase in capital budgeting would lead to a 0.008 increase in financial performance, a unit increase in portfolio management would lead to a 0.103 increase in financial performance, a unit increase in divided policy would lead to a 0.153 increase in financial performance and a unit increase in risk management would lead to a 0.399 increase in financial performance.

The study found out that the respondents were aware that the organizations’ firm size provides financial resources to acquire a new technology and enable spending on innovative activities. This shows that there exists a positive strong relationship between the accounting information systems and the ability of the employees to create financial statements and the responsibility for evaluating and using the information. These findings were similar to those of DeThomas and Fredenberger’s (1985) which indicated that 96 percent of the respondents had financial statements prepared, the responsibility for evaluating and using the information was within the
business itself and only four percent relied on an outside accountant. According to Raymond the accounting still was the most important and widely software in the small business studies.

The study revealed that from the financial management practices the delegation of decision making authority is one of the financial management practices used in the companies, this shows a positive significant relation with a study done by McMahon et al. (1993) the inadequacy of financial record keeping system in small enterprises was well documented in the main Bolton Report (1971) and in various supplementary research reports. This situation reflected a poor appreciation of the significance of financial management amongst owner-managers who were often technically-or sales oriented. Capital budgeting, planning and control were also some of the financial management practices that were used in the companies as indicated by the respondents.

The companies use inventory management practices in capital management and mainly realize importance of cash management in the process of planning and controlling cash flows. On cash management practices, according to Grablowsky (1978) and Grablowsky and Rowell (1980) the method employed cash management practices was to hold cash as a fixed ratio of projected expenses, forecasted sales or anticipated purchases. The most common investments were savings accounts, certificates of deposit, treasury bills, repurchase agreements, commercial papers, shares, bonds and other investments. Cooley and Pullen’s (1979) cash management was seen as the process of planning and controlling cash flows. It consisted of three basic components: cash forecasting practices, cash surplus investment practices and cash-control practices.
CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary
This chapter documented the findings of the research. The objective of this research was to investigate the effect of financial management practices on the financial performance of small and medium enterprises in Kenya. Descriptive research design was chosen because it enabled the researcher to generalise the findings to a larger population. The target population for this study targeted all the registered SMEs within Nairobi area. 520 respondents was the target population. From the above population of 520 possible respondents, a sample of 10% was used. Fifty two respondents were selected representing a population of 520 possible respondents using Stratified random sampling by taking 10% of the target population in each stratum. The organised data was interpreted on account of concurrence and standard deviation to objectives using assistance of computer packages especially SPSS version to communicate research findings. Tables and other graphical presentations as appropriate were used to present the data collected for ease of understanding and analysis. Factor analysis was used to explain correlations among multiple outcomes.

On working capital management, the study found that it was indicated that inventory, accounts receivable, accounts payable are some of the working capitals that the company uses to manage the business. It was also found out that one of the significant uses of the working capital in the company was inventory which keeps the company running. From the study, majority of the respondents were in agreement that business employed formal inventory control systems, SMEs should have common investments. The companies use inventory management practices in capital management and SMEs should realize importance of cash management in the process of planning and controlling cash flows. From the study the researcher also conclude that, inventory management practices in capital management affect the growth of small businesses in that they realize importance of cash management in the process of planning and controlling cash flows. The cash management consisted of three basic components: cash forecasting practices, cash surplus investment practices and cash-control practices.
5.2 Conclusions

From the study the researcher concludes that accounting information systems affected the growth of SMEs. These include cash management that has enabled the organizations to better their services to their clients focusing more towards value added services. The study also concludes that accessing accounting information services been greatly enhanced with the accounting technology that has enabled the globalization of the economy and facilitated competition. It has also subsequently brought about large scale change in the industrial nations and the occurrence of rapid growth of some industries.

The study also concludes that financial management practices used in the companies some lead to the inadequacy of financial record keeping system in small enterprises reflected a poor appreciation of the significance of financial management amongst owner-managers who were often technically-or sales oriented. This largely affects the growth of small and medium enterprises.

From the study the researcher also conclude that, inventory management practices in capital management affect the growth of small businesses in that they realize importance of cash management in the process of planning and controlling cash flows. The cash management consisted of three basic components: cash forecasting practices, cash surplus investment practices and cash-control practices.

In the regression model the study found that there was a positive significant relation between financial performance and accounting information systems (p= 0.000), working capital management (p= 0.000), Capital structure (p=0.38), Capital budgeting (p=0.000) and risk management (p=0.041).

5.3 Recommendations

The study recommends that since accessing accounting technology has over the years subsequently brought about large scale change in the industrial nations, there should be increased creation of new services and enhanced efficiencies. They should also be increase in
organizations’ firm size for financial resources to acquire a new technology and enable spending on innovative activities.

The study further recommends that the company’s financial management practices should be upgraded since it led to the inadequacy of financial record keeping system in small enterprises which affects the growth of small and medium enterprises. The study also recommends that the company should adjust their tight regulations and credit policies and the means of determining the creditworthiness of the SMEs and the credit appraisal. The company should educate the employees on book keeping.

The study also recommends that financial management practices used in the firms should be improved in order to improve of financial management which intern will improve financial performance.

The study also recommends that they should realize the importance of cash management in the process of planning and controlling cash flows. Further the study recommended that financial structure decisions which include cheaper cost of debt compared to equity; the cost of equity as debt increases; and the benefit of the tax deductibility of debt should be realized.

5.4 Limitations of the Study

In the pursuit of carrying out this study, various limitations were experienced. First, the research was limited to small and medium enterprises in Nairobi; hence the study did not incorporate the responses from other regions. This was due to limited time and resources.

There was reluctance of some respondents to complete the questionnaires promptly and others even failed to complete them at all. This thus limited the number of respondents involved in the study although the researcher gear up efforts and approaches to them explaining the potential benefits of the study.

There was limited literature and data on rates on effect of financial management practices on the financial performance of small and medium enterprises in Kenya. Hence the study relies much on literature and data relating to effect of financial management practices on the financial
performance of small and medium enterprises in other parts of the world especially the Western Countries. This factor thus limits the depth of discussions in the area of contributions rates on effect of financial management practices on the financial performance of small and medium enterprises in Kenya.

The researcher used drop and pick method to collect data. The researcher felt that this might have had an effect on the quality of data given by some respondents who lacked guidance in the answering some questions; as compared to where the researcher personally administers the questionnaire or use of research assistants.

5.5 Suggestions for Further Studies

The study explored the effect of financial management practices on the financial performance of small and medium enterprises in Kenya. However, the study was limited to SMEs located in Nairobi only and the results were generalized. The researcher recommends that a further study should be conducted on other SMEs in different parts of Kenya which have different settings. This would ensure comparison of results which could give us a clear picture on the effect of financial management practices on the financial performance of SMEs in Kenya.

The study found out that various SMEs adopted different financial management practices. The researcher therefore suggests a study to be conducted with an aim to investigate the factors that influence adoption of various financial management practices among small and medium enterprises in Kenya.

SME sampled varied in size and ownership; this is believed to have an influence on the management of the Small and Medium-scaled Enterprises (SMEs). In some, the owners manages the business while in others, a qualified manager is employed to manage the business. There is therefore the need to conduct a further research to ascertain the influence of owners on the adoption of financial management practices and their effect and further make a comparison with those that have independent managers.
A further study should also be conducted to determine the effectiveness of each financial management technique adopted by the SMEs and the challenges thereof. This would help in guiding other SMEs on the best techniques to manage finances and the challenges for each.
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APPENDICES

Appendix 1: Questionnaire

Part A:

1. Gender
   
   Male [ ] Female [ ]

2. Age

   Below 20 years [ ] 21-25 years [ ] 26-30 yrs [ ]
   30-35 yrs [ ] 36-40 years [ ] 40-50 years [ ]
   Above 50 years [ ]

3. Level of education

   Secondary [ ] diploma [ ]
   First degree [ ] post graduate [ ]

4. What is the total number of employees in your organization? Please tick one

   Less than 50 [ ] 50 – 100 [ ] Above 100 [ ]

Section B: Accounting information systems

5. In what cases has accounting information fundamentally changed the way business is conducted in your premises? 

   ...........................................................................................................
   ...........................................................................................................
   ...........................................................................................................

6. List other financial management practices you use in your company?

   ...........................................................................................................
7. If yes what are some applications of computer software do you use?

8. Is their inadequacy of financial record keeping system in your company?

   Yes ( )  No ( )

9. Do you agree with the following statements on Accounting Systems? Use the scale where
   1- To no extent; 2- To a little extent; 3- To a moderate extent; 4- To a great extent and 5
   is to a very great extent

<table>
<thead>
<tr>
<th>Statement</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting technology has enabled the globalisation of the economy and</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>facilitated competition</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>It has subsequently brought about large-scale change in the industrial</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>nations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>There is rapid growth of some industries such as computer, communications,</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>software and financial services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>It has creating new services and enhancing efficiencies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Traditional industries have stalled or even contracted in comparison</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>It is transforming the landscape, accounting is enabling a major</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>shift in the job</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Section C: Working Capital Management

10. List some of the working capital you use in your company?

11. Do you agree with the following statements on working capital management? Use a scale
    where1- Strongly disagree; 2- Disagree; 3- Neither agree or disagree; 4- Agree and 5-
    Strongly agree

<table>
<thead>
<tr>
<th>Statement</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMEs should have common investments</td>
<td></td>
<td></td>
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</tbody>
</table>
SMEs should realize importance of cash management in the process of planning and controlling cash flows

<table>
<thead>
<tr>
<th>Businesses employed formal inventory control systems</th>
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<tbody>
<tr>
<td>SMEs use inventory management practices in capital management</td>
</tr>
<tr>
<td>Do SMEs use quantitative technique when doing survey</td>
</tr>
</tbody>
</table>

12. Do you agree with the following statement on aspects to be considered by each SME in the market? Use the scale where 1- To no extent; 2- To a little extent; 3- To a moderate extent; 4- To a great extent and 5 is to a very great extent

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce inventory</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Develop just-in-time (JIT) systems</td>
<td></td>
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<tr>
<td>Pressure to increase quality</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Decrease time to market</td>
<td></td>
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</tr>
</tbody>
</table>

13. Do you agree with the following statement with regard to financial management practices of financial performance used in your company? Use the scale where 1- To no extent; 2- To a little extent; 3- To a moderate extent; 4- To a great extent and 5 is to a very great extent

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting Information Systems</td>
<td></td>
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</tr>
<tr>
<td>Working Capital Management</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Capital Structure</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Budgeting</td>
<td></td>
<td></td>
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<tr>
<td>Portfolio Management</td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>Divided</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk Management</td>
<td></td>
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</tr>
</tbody>
</table>

THANK YOU
### Appendix II: Secondary Financial Information for the SMEs

<table>
<thead>
<tr>
<th>Sales Volume for 2011</th>
<th>Expenses for 2011</th>
<th>Profit for 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>10,063,000</td>
<td>6,560,040</td>
<td>3,502,960</td>
</tr>
<tr>
<td>8,153,850</td>
<td>3,150,550</td>
<td>5,003,300</td>
</tr>
<tr>
<td>7,002,650</td>
<td>4,982,060</td>
<td>2,020,590</td>
</tr>
<tr>
<td>7,228,380</td>
<td>4,877,500</td>
<td>2,350,880</td>
</tr>
<tr>
<td>6,005,230</td>
<td>4,988,080</td>
<td>1,017,150</td>
</tr>
<tr>
<td>6,461,000</td>
<td>4,502,120</td>
<td>1,958,880</td>
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<tr>
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<td>4,183,036</td>
<td>1,359,067</td>
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<td>1,304,206</td>
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<tr>
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<td>3,025,020</td>
<td>2,000,004</td>
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<tr>
<td>5,554,210</td>
<td>4,004,520</td>
<td>1,549,690</td>
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<tr>
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<td>3,987,305</td>
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<td>820,640</td>
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<td>3,001,820</td>
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<td>2,082,600</td>
<td>2,141,425</td>
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<td>1,808,000</td>
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<tr>
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<td>1,802,210</td>
<td>1,722,870</td>
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<tr>
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<td>1,075,440</td>
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<td>1,299,990</td>
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<tr>
<td>23.</td>
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<td>32.</td>
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<td>33.</td>
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<td>34.</td>
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<td>852,090</td>
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