A STUDY ON THE DETERMINANTS OF FINANCIAL DISTRESS IN SMALL AND MEDIUM ENTERPRISES: A CASE STUDY OF NAIROBI COUNTY

BY

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DECLARATION

This project is my original idea and has not been presented for research in any other University.

Sign……………………………………………Date……………………….

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This project has been submitted with my knowledge as the appointed University supervisor.

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DEDICATION

I dedicate this work to my parents Mr. Steven Gathiomi and Ms. Lucy Kabuthi and my siblings Alice, Emma and David for being a constant source of inspiration. Their concern, support, encouragement and enthusiasm inspired me to achieve this goal.

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ABBREVIATION

CBK	Central Bank of Kenya
FA	Factor Analysis
GDP	Gross Domestic Product
KNBS	Kenya National Bureau of Statistics
MDA	Multiple Discriminant Analysis
NSE	Nairobi Security Exchange
SMEs	Small and Medium Enterprises
UN	United Nations
USA	United States of America

ABSTRACT

Financial distress in small and medium enterprises (SMEs) is a common phenomenon in the world today and thus attracting the interest of scholars, government and policymakers. The SMEs are the leading drive to the national economic development. They are the means through which the government eradicates poverty through enhancing entrepreneurship and by creating employment. This research project seeks to find the causes of financial distress on SMEs to enable them to avoid financial distress, curb its effects and to ensure continuous and sustainable growth. The study was conducted through a case study design which is an in-depth investigation of a phenomenon (Mugenda, 2003). Data collection entailed the adoption of a questionnaire in the form of a five-point Likert Scale in a sample of 100 SMEs. Out of the issued questionnaires, a total of 79 were returned. Data analysis was done through the SPSS and presented in the manner of a regression analysis. Data validity and reliability was established by ensuring lack of Multicollinearity and looking into skewness and kurtosis. The study findings indicate that there is a significant relationship between financial distress and inadequate capital, poor succession planning and governance, poor government policies and lending rates. There is, however, an insignificant relationship between financial distress and large debt, managerial skills, and competition. If inadequate capital increases by 1 unit, financial distress increases by 0.28. If poor succession and planning increases by 1 unit, financial distress increases by 0.185. If large debts increase by 1 unit financial distress increases by 0.033. If inadequate managerial skills and accounting systems increase by 1 unit financial distress decreases by 0.100. If poor government policies increase by 1 unit financial distress increases by 0.131. If Competition increase by 1 unit financial distress decreases by 0.074, and if lending rates increase by 1 unit financial distress increases by 0.138. The study makes the recommendation that SMEs keep good financial records to ensure reliable study in the area. Further, the government needs to adopt policies that ensure SMEs do not fall into financial distress.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The SMEs are the leading drive to the national economic development. They are the means through which the government eradicates poverty through enhancing entrepreneurship and by creating employment. Consequently, SMEs enhance innovation and creativeness and thus enhance market competition (Jahur & Quadir, 2012). In Kenya, SMEs play an essential role in the country's economic growth and development. Therefore, the causes of financial distress among SMEs need to be identified and solved. The contributions of Altman (1968) and Beaver (1966) among others have provided essential literature on financial distress, however not much research has been done on causes of financial distress on SMEs due to difficulty in accessing their financial data and other information.

There are several theories which back financial distress. This study incorporated the Credit risk theory by Merton (1974). The theory defines default as a process characterized by parameters known as structural models. Credit risk is the risk that a debtor will not make the required payments. Firms undergoing financial distress are not able to meet their maturing obligations. The Cash management theory as described by Mao (1978) outlines the importance of a firm controlling the cash inflows and outflows to strike a balance and avoid being financially distressed. The Entropy theory uses information obtained from the balance sheet of the company to identify firms undergoing financial distress.

Financial distress causes can either be endogenous or exogenous causes. While endogenous causes are internal problems that affect only a specific firm, exogenous

causes are problems that affect firms in an industry, and therefore firms have no control over (Karels & Prakash, 2006). Internal problems causing financial distress include management efficiency, adoption of poor accounting policies, poor resource management, and inadequate planning for succession. External factors such as competition, lending rates, natural disaster, government policies and fluctuation of lending and inflation rates also can lead a firm to financial distress. While all this factor can cause financial distress in a firm, Memba (2012) established that endogenous risk factors were the major causes of financial distress as compared to exogenous factors.

1.1.1 Financial Distress

There are many terms used to describe financial distress. It can be used to describe deferment of remittance to short-term lenders, liquidation and lateness of payment on principal on bonds or payment of interest or the omission of a preferred dividend (Kumar, 2017). Consequently, it is a situation where a company's operating cash flows inadequately meet current maturing obligations, and the company is forced to take a corrective action (Akinsola, 2017). Financial distress is best understood regarding business failure, failure to pay maturing obligations, bankruptcy or distressed restructuring (Gilson, 1989).

According to Andrade & Kaplan (1997), financial distress occurs in two forms, the first one occurs when a company defaults on maturing obligation while the second one occurs when a company undertakes debt restructuring in an attempt to prevent being in default this being the corrective action described by Akinsola (2017). Financial distress occurs when a company cannot fulfill its liabilities to third parties (Andrade & Kaplan, 1997). He further stated that when entering financial distress, a company faces one of two

possibilities; one is either cash shortage on the asset side of the balance sheet or a debt hang in liabilities.

Financial distress is a situation where a company's cash flows are insufficient and can therefore not meet maturing obligations (Wruck, 1990). He stated that financial distress could serve as a company's warning device, for example, a reduction in the level of dividends issued or non-issue, or retrenchment of employees and resignation of top management can be an indicator of a company under financial distress. Whitaker (1999) explained that a company is financially distressed if its first year of cash flow is lesser than the long-term debt of the company that is soon due.

Gordon (1971) came up with a theoretical model describing financial distress as a state between solvency and insolvency. As a rule of the term, financial distress describes something negative; it describes the financial situation of a company faced with temporary cash flow problems. Also, it can be used to describe a company having challenges to meet maturing or current obligations. He further explains that financial distress is a situation where firms lack adequate proceeds to fulfill their maturing obligations. A firm enters into an insolvency state after the maturity of the debt obligations Gordon (1971).

1.1.2 Causes of Financial Distress

Karels & Prakash (2006) established that the factors that could lead a firm to financial distress could be categorized into two; endogenous and exogenous causes. The endogenous causes constitute of the unsystematic risk factors that are firm-specific, while the exogenous risk factors affect all firms in the economy although not to the same

extent. Memba (2012) established that the endogenous risk factors are the major causes of financial distress in most firms as compared to the exogenous factors.

Adeyemi (2011) noted that the lack of adequate capital is among the major factors leading to financial distress. Capital can absorb losses. Therefore, presence or absence of capital in a firm affects its ability to deal with losses. He also pointed out that factors like ownership structure, weak or ineffective internal control system, weak accounting system, and poor management are drivers of corporate failure. Financial distress among firms can take different forms that range from high default cases on corporate loans, inability to pay dividends to shareholders and management wrangles (Adeyemi, 2011).

The main reasons behind financial distress can be attributed to inappropriate asset mix, corporate governance or financial structure (Gilbert, 1990). According to Natalia (2007) factors such as large debts, uninformed expansion, intense competition and large legal costs are causes of financial distress. Consequently, lack of skilled managers in a firm can lead to making of unhealthy decisions for a firm which in turn led to financial distress (Ooghe& De Prijcker, 2008).

Financial distress is associated with both direct and indirect costs (O'Neill, 1986). The direct costs include legal fees, auditor expenses and other payments associated with bankruptcy proceedings. The loss of value prior to bankruptcy can be referred to as indirect cost which include decrease in level of sales and good will. Both the direct and indirect costs according to O'Neill (1986) are causes of financial distress

Hiatt, Saine, & Wesley (2012) assert that poor or favorable government policies impact on organizational growth. The government plays an important role in creating the

environment in which organizations operate. It is responsible for the enactment of business laws, enforcement of contracts, provision of social amenities, protection of private property and protection against outside competition. Environments led by weak governments with high levels of political and civil wrangles led to financially distressed firms. Consequently, enactment of laws that tend to oppress entrepreneurs causes financial distress. For example, high tax charges, poor management of public resources leading to inflation and abolishment of interest caps on lending rates in the end leads to financially distressed firms (Hiatt, Saine, & Wesley, 2012).

1.1.3 Small and Medium Enterprises in Nairobi County.

Small and medium enterprises have gained recognition globally for the role they play in enhancing economic growth. In Kenya, most SMEs started as family owned businesses. Some grew into large enterprises while others stabilized without changing the scale of operation. Others disappear (Bhalla, 1992). Although according to (Gray, 2018) the main reason for starting up a business is due to shortage of formal employment in the economy, in Kenya, people start a business for three main reasons; increased income, self-employment and having the required skills (Small Medium Enterprises Today - State of MSME Sector in Kenya)

Small and Medium enterprises are the steering wheel for economic growth of a country. They are the means through which economic development and rapid industrialization can be achieved (Mather, 2005). In Nairobi County, there are 1000 registered SMEs, they constitute of 98 per cent of all businesses available in the county (Economic survey 2017, 2017). Most of this SMEs are family owned, and therefore source their capital from friends and family. They contribute to 27.8% of jobs available in the county and therefore

are the largest contributors to the poverty reduction and economic growth county goals. Despite their tremendous contribution to economic growth in Nairobi County, SMEs face challenges that make them financially distressed. According to KNBS (2005), SMEs have high mortality rates with most of them not surviving their third birthday.

Nairobi County is inadequate capital. Thirty per cent of the firms affirming that increased operating expenses, low income and losses incurred are the major causes of inadequate capital. Diversion of profits and operating capital from the firm to other uses eventually leads to financial problems (Ngugi, 2016). In addition, competition from cheap imports also contributes to cash flow problems among SMEs due to reduces sales and there zero or declined profits.

According to the Economic survey (2017), unskilled management and poor management of resources leads to firms being financially distressed. The survey observed that 5 per cent of entrepreneurs attributed their failures in business, to inadequate skills. Large debts and unfavorable borrowing requirements also lead to businesses being financially distressed. Large debts and high interest rates on debts have led to firms being financially distressed, 80 per cent of SMEs that closed business in 2016 had large debts they were not able to service (Economic survey 2016,2016). Consequently, other SMEs were reported to have faced financial distress due to other personal issues, which ranged from social and biological obligations like prenatal and postnatal care of children especially for women (Economic survey 2016,2016).

1.2 Research Problem

Despite the significant role played by SMEs in the Kenyan economy, they often face financial distress that adversely affect their development and limit their potential to boost the economy as desired. Financial distress affects the whole industry at large but, in this proposal, I will concentrate on its causes. There are various causes of financial distress which can be categorized into two; micro level factors also known as endogenous factors and exogenous or macro level factors (McNamara, Duncan, & Kelly, 2011). Micro level factors are the major causes of financial distress, if a firm is able to deal with the internal causes of distress then it has partially succeeded in solving its financial problems (Memba, 2012).

A 2016 survey by the KNBS indicated that over 400000 SMEs formed in Kenya close business before their second year of operation. Consequently, only a few get to celebrate their fifth birthday and thus raising eyebrows of sustainability of this important sector ("Economic survey," 2016). In Nairobi county, 98 per cent of businesses constitutes of SMEs, there are 1000 registered SMEs ("Economic survey 2017," 2017), 30 per cent of which attributed financial distress to inadequate capital while 5 per cent attributed it to inadequate managerial skills.

Endogenous causes are characterized to a certain firm, matters of ownership, governance, operating risk and leverage can be classified as firm level causes of financial distress (Pandey, 2015). For example, management may be unskilled and therefore matters pertaining marketing, finance or production may be a problem. In addition, they may fail to put credible and sensible accounting, budgeting, and control systems in place. Finally,

the firm may lose one or a few key players on which production or management is dependent leading to financial problems.

Macro level factors such as competition causes negative shock to an industry's product demand or costs especially if it is sustained over time. The weakest firm will eventually be forced out of the market or must consider being acquired by a stronger firm in the industry (Memba, 2012). The industry shocks contribute to the frequency of takeovers or restructuring. Other industry level factors include raw materials accessibility. Firms that acquire raw materials at a lower cost incur lesser costs of production and the reverse is true.

Exogenous causes like recessions create financial distress by narrowing the margin between cash flow and debt service (McNamara et al., 2011). Surveys have established that's luck of finances is a major cause of financial distress to SMEs. This occurs when firms have limited funds to run daily operations (Memba &Nyanumba, 2013). Corruption and other unfavorable regulatory environments, also play a big role in the closure of SMEs (Deloitte, 2016).

This research project seeks to find the causes of financial distress on SMEs so as to enable them avoid financial distress, curb its effects and to ensure a continuous and sustainable growth.

1.3 Research Objective

To determine the causes of financial distress on Small and Medium Enterprises in Nairobi county.

1.4 Value of the Study

In the globalized economy there is increasing recognition that identifies causes of financial distress in SMEs. Although the Kenyan government has made the process of opening up a business easy, the rapidly growing economy has also opened borders for international trade; therefore, SME's have a high chance of being shaken out of the economy when they suffer financial distress. The study will enable management and policy makers come up with feasible to enhance the effectiveness and sustainability of SME's in Kenya.

This research will also be of great use to scholars and students as a source of reference while undertaking research in this area. The study will be useful to the government when implementing vision 2030 on employment reforms especially for the youth, industrialization reforms and eradication of poverty. This will bring about economic growth of the country. The government can also use it in apportioning revenues to be used in credit creation, subsidies and incentives for SME's during budgeting. Investors may also use it in determining on how viable investments are, how to avoid and curb the effects of financial distress.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter explores theories describing financial distress, empirical literature on the probable causes of distress and the conceptual framework

2.2 Theoretical Literature Review

Some theories have been developed on causes of financial distress. Therefore, theoretical literature will be reviewed using credit risk theory, cash management theory and entropy theory.

2.2.1 Credit Risk Theory

Credit is the provision of goods and services to an individual or an entity before them having made payment, based on an agreement that payment be made at a future date. During the contract period, creditors are not always able to receive due amounts from debtors. Therefore, when a debtor fails to honor his promise to pay on time, he exposes the creditor to credit risk. Therefore, this risk is the lenders risk of loss which can be either financial or otherwise and arises when a debtor fails to honor the maturing obligations as stipulated in the contract (Nyunja, 2011).

Merton (1974) developed the credit risk theory as the structural theory. According to the theory, default arises through a diffusion process. This process is distinguished by external parameters known as structural models. Through the models, default risk is innate and thus, default on the agree terms may occur at any time during the period of the debt instrument. There are three quantitative approaches of applying credit risk; structural approach, reduced form appraisal and incomplete information approach (Lin, Lou, &

Zhan, 2014). However, Merton uses credit spread and credit portfolio management approaches of measuring credit risk.

Credit spread provide analysts with an important way to extract an estimate of default embedded within the financial contract by observing market prices of underlying assets, while credit portfolio management approach allows credit managers to look at tradeoffs among different types of assets from a credit perspective, drawing on theory first applied to investment management. Therefore, Credit risk is the risk that a lender faces when the borrower fails to make required payment. Although not all SMEs operate by acquiring goods on credit, a firm under financial distress is most likely to default on maturing obligations and that's why this assertion is important.

2.2.2 Cash Management Theory

Cash is an important short-term asset in an organizations' balance sheet, it plays a significant role in ensuring an organization remains liquid and prevents it from being bankrupt. Cash management describes the manner in which a firm manages the cash that flows in and out of the firm by investing surpluses and financing deficits (Aziz & Dar, 2006). This theory was introduced by Mao & Sarndal (1978). According to Mao & Sarndal (1978) cash management is keen on a firms' liquidity. The theory posits that every firm should ensure corporate cash balances are appropriately managed.

According to Weston & Copeland (1992), cash management is concerned with optimal use of available cash, maximum utilization of interests earned by extra funds not required immediately and reduction of losses caused by delays in fund transmission. Holding cash to meet current needs incurs an opportunity cost, this cost is equivalent to the return

which could be earned if the cash was invested. However, operating with minimal cash balances increases the risk of a firm being unable to pay debts as they are due, therefore, there is need to determine the optimal cash balance of the firm.

Efficient cash management involves determination of the optimal cash to hold by considering the tradeoff between the opportunity cost of holding too much cash and the trading cost of holding too little (Atrill, 2003). Cash management is used to determine the optimal level of cash required for the business operation and the investment in marketable securities (Modugu & Eboigbe, 2009).

According to Keynes (1990) businesses hold cash for three motives: precautionary, transaction and speculative. The transaction motive for holding cash is the most important for SMEs since most of them depend on cash to run their day to day operations. Although this theory is keen on ensuring the use of a firm's cash to the maximum, its limitation is in that cash flows are a result of independent trials hence actions by management do not affect the results. Therefore, this means that the management cannot maintain equilibrium between cash inflows and cash outflows. However, persistent cash imbalance may make a firm may undergo financial distress.

2.2.3 Entropy Theory (Balance Sheet Decomposition Measure Theory)

The entropy theory was introduced by Moyer in 1977. The entropy theory enables analysts to identify firms undergoing distress by observing the changes occurring in their balance sheet. However, the theory has its weakness as it focuses only on the changes occurring in the balance sheet structure not considering the reason behind the change (Aziz & Dar, 2006). This fact, according to Moyer (1977), limits the ability of the theory

to distinguish between a firm whose balance sheet changes are not due to failure but due to growth. Therefore, there is need to use the Multiple Discriminant Analysis. MDA is a statistical analysis that enables a researcher to analyze more than one variable. Its aim is to eliminate the weakness in the univariate analysis (UA). Researchers employ MDA technique to distinguish between non-distressed and distressed units.

2.3 Empirical Literature Review

Galloway & Jones (2006) established that companies that failed to plan and prepare on matters of succession by training people taking up key positions in companies faced financial distress over a period of time. Luck of training makes firms absorb unskilled manpower who in turn make fatal investment decisions that may led to closure of a firm. They also established that fund management would be a problem among unqualified managers, loss of funds for a firm leads to financial distress since, cash acts as a cushion that enables a firm resist loss not provided for in the current earning trends (Adeyemi, 2011).

In their research on the causes of financial distress in SMEs of Bangladesh, Jahur and Quadir (2012) describe financial distress as the inability of a business to pay its current obligations on the dates they are due. They highlighted that the major causes of financial distress for SMEs is fund mismanagement and credit availability. They further established that fund mismanagement could be as a result of luck of managerial skills employment of poor accounting systems or mismanagement of funds. Innovation could also make a firm undergo financial especially if it gives competitors, competitive advantage (Jahur & Quadir, 2012). They also explained that SMEs that undergo financial

distress end up being secured by creditors since they have only a few assets as a way of paying themselves.

Zammel (2016) in his research on causes of Tunisia SME failure, established that causes of financial distress can be classified into external (macro) or internal (micro) causes. Macro (exogenous) factors are those factors that affect an entire section of the market while the micro (endogenous) factors are usually firm specific (Pandey, 2015). He classified the macro factors into general and market causes, while the internal causes were either managerial or company-initiated causes.

Andrea (2018) explains that banks and SACCOs have a role to play on the financial distress faced by SMEs. According to his study very few SMEs keep good financial records, therefore they are not able to meet banks qualifications for debt financing leading to financial strain. In addition, financial institutions require collateral for them to finance SMEs which also poses a problem. SMEs therefore luck funds to meet their objectives leading to financial distress.

Wagana (2014) in research on the relationship between capital structure and financial performance of SMEs in Nairobi established that most SMEs prefer debt to equity financing. Debt financing, is perceived as a cheaper source of funding and that it lowers the taxes paid since it acts as a tax shield. He also argues that SMEs prefer debt financing since access to equity is expensive and creates complexity in managing SMEs if embraced. The fact that most SMEs rely on debt leads to them being financially distressed in the event that they are unable to meet their obligations on time.

In their research on factors affecting financial performance of SMEs in Kenya, Ombongi & Long (2018) established that bank loans affect the financial performance of SMEs

positively or adversely. While luck of funds from inability to get bank, loans pushes businesses out of the economy due to financial distress, availability of bank loans that tend to be expensive also leads to business closure once firms are incapable of paying the high interest rates. Bank regulations requiring SMEs to provide collateral makes them opt not to borrow. In addition, over borrowing among SMEs led to bankruptcy, therefore SMEs managers should try not to load the business with more loans than their capacity to pay (Kanugi & Gichira, 2017). These factor makes them undergo distress leading to bankruptcy if the problem is not mitigated.

Mwangi (2017) observed that causes of financial distress for SMEs were rapid changes in technology, limited market access, insufficient capital, inadequate knowledge and skills, and poor infrastructure. In addition, corruption and government regulations with regards to matters of tax and imports provided other bottlenecks to financially distressed SMEs in Kenya.

2.4 Conceptual Framework

This research will be organized into endogenous and exogenous causes of financial distress as the independent variable with financial distress as dependent variable. The endogenous variables refer to internal causes of distress. These factors can be attributed to management inefficiency, adoption of poor accounting and financial policies, poor resource management, adoption of poor trade policies, and improper management succession.

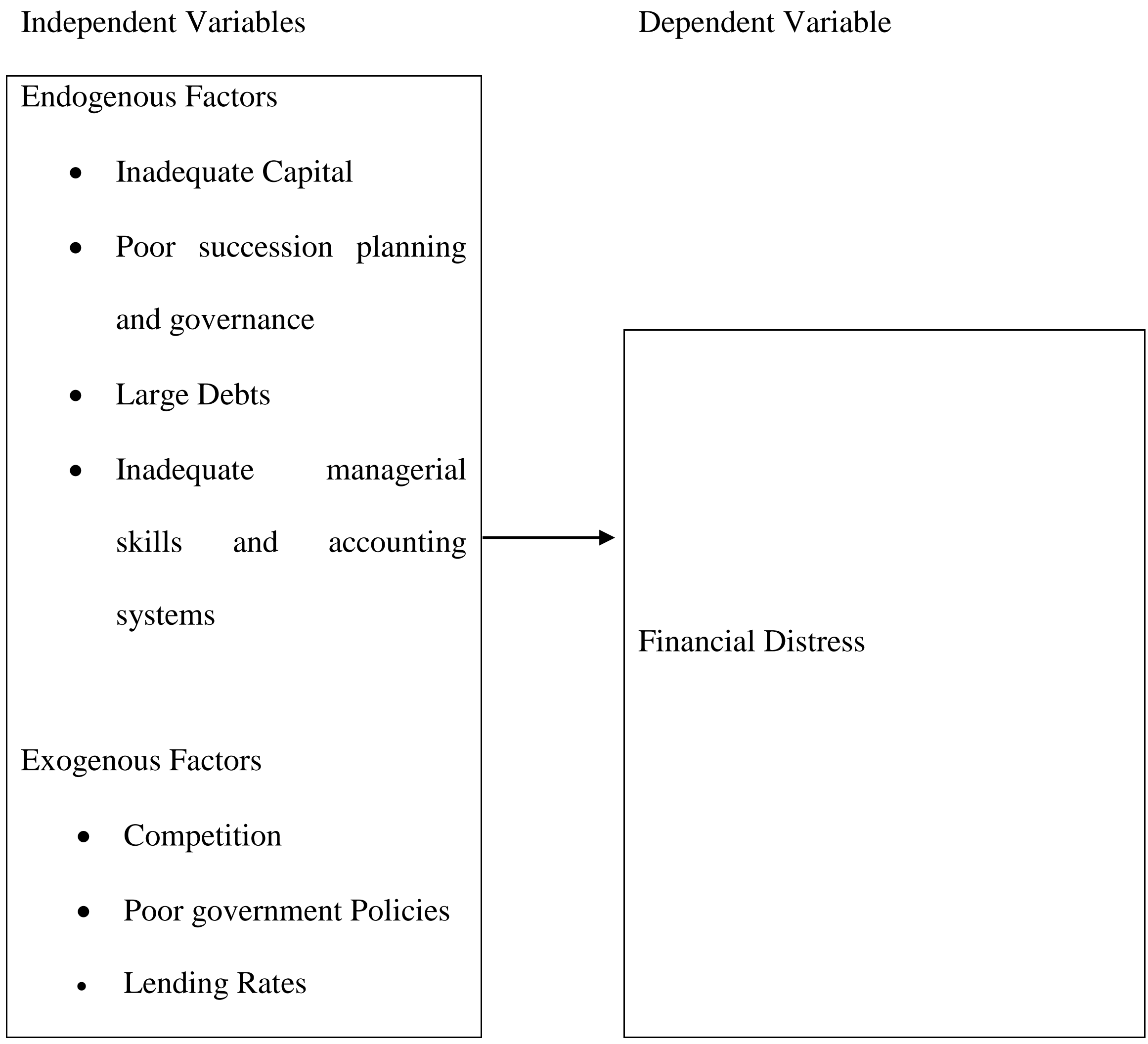

Figure 1. Conceptual framework

The exogenous factors are usually do not depend on managerial skills and can therefore affect all firms in the economy (Karels & Prakash, 2006). They include competition, increased borrowing rates, natural disaster, government policies, fluctuation in exchange rates and inflation among others.

2.5 Summary of Literature Review

The literature review entails three theories; Cash Management theory, Entropy theory and Credit risk theory. The causes of financial distress were also highlighted and classified into endogenous and exogenous causes of financial distress. The empirical review included works done by both international and local authors. From the literature reviewed the theories discussing financial distress portrayed some weaknesses and therefore cannot be used in isolation.

The Entropy theory has limitations in that it will be difficult to identify firms that can undergo financial distress if they do not keep a balance sheet. This is due to the reason that it will be difficult to come up with important trends in the composition of assets and liabilities. Consequently, there are SME's that do not give out credit services to their customers, hence it won't be possible to apply the credit risk theory the firm won't suffer from bad debts.

Galloway and Jones (2006) argued that a firm has to undertake the management succession plan for key roles and identify high potential in the company's employees. This does not have to be the case to avoid financial distress in SME's since most of the SME's do not have a detailed management structure and do not have many employees. Therefore, the study will determine the causes of financial distress n SMEs factoring in all the highlighted short comings.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

Research methods are systematic procedures and techniques used to identify, select, process and analyze data when conducting a research (Saunders, Phillip, & Adrian, 2009). Hence the Research Design, Data Analysis Techniques, Sample design, Target Population, Data Collection Instruments and Presentation will be detailed in this section.

3.2 Research Design

A research design is a plan that guides the researcher when conducting a research. It enables the researcher remain on course by providing strategy on how the research will be conducted (Shukla, 2010).

Therefore, this study was conducted through a case study design. A case study is an in-depth investigation of a phenomenon (Mugenda, 2003). This design was suitable in the study since it provided a researcher with a wider viewpoint relating to the research concept. According to Ooghe and Prijcker (2008), it is also helpful when a researcher is covering sensitive topics that involve use of confidential information that includes financial information of a company.

3.3 Target Population

A population is any finite or infinite collection of individual elements. A target population is one which a researcher seeks to base the study’s findings (Mugenda, 2003). The study will focus on SMEs and narrow to register SMEs in Nairobi County. There are 1000 registered SMEs in Nairobi County (Economic survey, 2017). According to Mugenda (2003), a sample size of 10% of the population is adequate for descriptive

study. Therefore, the target population in this study comprised of 100 SMEs registered in Nairobi County (as per Nairobi City Council).

3.4 Sample Design

According to Orodho and Kombo (2002), sampling is the act of selecting several objects or individuals from a group such that they contain elements that are representative of characteristics of the whole population.

Purposive/judgmental sampling was used in the research to select the cases to be studied. Mugenda (2003) argues that purposive sampling enables the researcher to employ individuals that have the needed information with respect to the objectives of the study. On the other hand, case studies were handpicked because they possessed the needed information.

3.5 Data Collection

Data collection involves the process of gathering evidence to confirm the insights of a phenomenon (Mugenda, 2003). The study was done through obtaining primary data. The data was collected through administering questionnaires. The study employed both structured and unstructured questions. In this case, primary data was obtained on a Five Point Likert Scale, open ended and closed ended.

The Likert scale method was most suited for this study since it deals with variables that the researcher could not obtain directly. As for the open-ended questionnaire, it does provide the respondent with a set of choices to choose from, instead the respondent is free to answer in any manner they deem fit. On the contrary, a close ended one provides participants with a set of choices to choose from. The questionnaire method was used

because of its fastness when collecting data, versatile and affordability as many business problems can be addressed at ease (Gupta, 2008). Lastly, managers, employees and finance consultants of sampled SMEs were the respondents in the study.

3.6 Data Analysis

Data analysis is the task of methodically using arithmetic and rational methods to define, demonstrate, condense, review, and assess data. This task is developed to deal with manipulation of the information that has been gathered so as to present the evidence (Gupta, 2008). The data obtained through questionnaires was edited, tabulated and analyzed. Meanwhile, financial distress variables' groupings will be dictated by the inherent relationships among variables. The study used SPSS version 21 for data analysis. It was used because it is systematic and covers a broad spectrum of statistical and graphical data analysis.

3.6.1 Diagnostic Test

The nature and strength of the correlation between the measured (dependent) variable and explanatory (independent) variables will be measured through various diagnostic tests such as the tests for Multicollinearity and tests of normality. Multicollinearity occurs when there is high intercorrelation among independent variables. This correlation is a problem because independent variables should independent. To determine the level and presence of collinearity, a researcher uses a correlation matrix. A correlation matrix helps in determining presence of collinearity and independent variables with collinearity of more than 0.8 are assumed to have severe Multicollinearity and should be adjusted to fit in the study model (Saunders, Lewis & Thornhill, 2015).

Normality test is done because it is impractical to achieve accurate and reliable deductions about the reality on whether the population that the sample is derived is normally distributed (Ghasemi & Zahediasl, 2012). This study will use Shapiro-Wilk test of normality and the graphical method to assess whether the data is normally distributed.

3.6.2 Analytical Model

The relationship between financial distress and the causes of distress was expressed through a linear equation of the form illustrated below;

$$Y_i = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 X_7\ €$$

α =constant

Y_i = Financial Distress based on the Altman Z score

X_1= Inadequate Capital

X_2= Poor Succession Planning and governance

X_3= Large Debts

X_4= Inadequate managerial skills and accounting systems

X_5 = Poor Government Policies

X_6= Competition

X_7 = Lending Rates

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6$ & β_7=co-efficient of the model

€ = the stochastic error terms

3.6.3 Test of Significance

The test for joint significance of all coefficients was done using the F-test while the test for individual coefficient was done using the T-test. The significance of the regression model was determined at 5% and 95% confidence interval.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

The analysis and presentation of data are covered in this topic. The study aimed at establishing the causes of financial distress on SMEs in Nairobi County. The population consisted of registered SMEs in the county. Questionnaires were deployed in the collection of primary data while financial records of the firms served as the secondary.

4.2 Response Rate

The study sort to gather information from managers and owners of 100 registered firms in Nairobi County on the causes of financial distress on SMEs. However, of the total of 100 firms selected, 79 firms responded constituting 79% of the total population. According to Mugenda and Mugenda (2003), this response rate was excellent since a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good, and a response rate of 70% is above excellent.

Table 1: Response Rate

	Frequency	Percentage
Responded	79	79
Not Responded	21	21
Total	100	100

Source, Author, 2018

The respondents in the study indicated that 80% of the SMEs do not maintain books of accounts while 90% of those that have books of accounts do not have an accounting information system. The SMEs were seen not to hire an expert to maintain their financial records and thus fill in data independently.

4.3 Data Validity and Reliability

Data validity relates to the ability of measures of data analysis to remain consistent over time, across the items of study (internal consistency) and across various researchers. Cronbach alpha is the most common measure of internal consistency. A Cronbach alpha of above 0.8 is an indicator that the data is valid and can be used in future studies.

Table 2: Reliability Statistics

Reliability Statistics		
Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.794	.806	8

Source, Author, 2018

The study on the causes of financial distress in SMEs produced a Cronbach Alpha of 0.806 which is within the acceptable levels. It is an indicator that the findings in the study can be relied upon for concluding.

4.4 Descriptive Statistics

Descriptive statistics are essential in describing the features of the data and giving a summary of the measures under the study. Descriptive statistics merely bring out what

the data shows. The main descriptive statistics include the mean, the standard deviation, kurtosis, and skewness.

4.4.1 Mean and Standard Deviation

The mean is a measure of central tendency that shows the average of the data. The standard deviation is a measure of dispersion that shows the concentration of the data around the mean. A higher standard deviation is an indication that is an indicator that data is dispersed from the mean, while a smaller standard deviation is an indication that data is more concentrated around the mean.

Table 3: Mean and Standard Deviation

Item Statistics

	Mean	Std. Deviation	N
Financial Distress	4.10	.612	79
Inadequate Capital	2.96	.706	79
Poor Succession Planning and governance	3.01	1.019	79
Large Debts	3.10	1.128	79
Inadequate managerial skills	3.05	.973	79
Poor Government Policies	3.01	1.056	79
Competition	2.47	.713	79
Lending Rates	3.04	.980	79

Source, Author, 2018

The means in the data range from 4.1 in financial distress with the lowest mean being on competition. Respondents in the study were requested to decide the level to which they

agree with the statements indicated in the questionnaire through a Likert scale showing on a rate scale of 1 to 5 where 1= very great extent, 2= great extent, 3= moderate extent, 4= low extent and 5 no extent at all. The means in the study are an indicator that financial distress is considered a very important variable. Lending rates, large debt, poor planning are also seen to moderately influence financial distress with the least likely to lead to financial distress being competition and inadequate capital. The data under the study had high standard deviations ranging from 0.612 in financial distress to 1.128 in large debts. It is an indicator that there are varying attitudes on people towards financial distress and the factors leading to financial distress such as large debts.

4.4.2 Skewness and Kurtosis

Skewness is the measure of symmetry or a lack of it. Symmetrical data means that data is distributed evenly on the left and the right at the central point. Skewness in a normal distribution is zero and data that is symmetrical should have values closer to zero. Skewness of between -1.96 to +1.96 is considered within the normal distribution (Trochim, 2006). Kurtosis on the other hand measures whether data is heavy-tailed or light tailed relative to a normal distribution. Low kurtosis is an indication that data has a light tail while high kurtosis indicates heavy tails. Kurtosis levels between -2 to +2 are considered acceptable to prove the existence of normal univariate distribution.

The data in the study provides skewness of between -1.96 to +1.96 meaning that the data is of normal distribution while kurtosis lies between -2 to +2 with the values being low and close to zero meaning that the data has a light tail as shown in the table below

Table 4: Skewness and Kurtosis

	N	Skewness		Kurtosis	
	Statistic	Statistic	Std. Error	Statistic	Std. Error
Financial Distress	79	-.055	.271	-.293	.535
Inadequate Capital	79	.054	.271	.384	.535
Poor Succession Planning and governance	79	.496	.271	.206	.535
Large Debts	79	.181	.271	-.843	.535
Inadequate managerial skills	79	.411	.271	.517	.535
Poor Government Policies	79	.175	.271	-.423	.535
Lending Rates	79	.090	.271	.146	.535
Competition	79	.332	.271	-.129	.535
Valid N (listwise)	79				

Source, Author, 2018

4.5 Correlation Analysis

The correlation coefficient is an indicator of the extent to which data scatters from a straight line. The Pearson correlation coefficient is a test statistic that measures the statistical relationship or association between two variables. It is an indicator of the magnitude of the association. Correlation coefficients lie between +1 and -1. Values closer to -1 indicates that variables are highly negatively correlated while values closer to +1 indicates that values are highly positively correlated. 0 indicates that values do not have any linear relationship.

Table 5: Correlation Analysis

Correlations

		Financial Distress	Inadequate Capital	Poor Succession Planning and governance	Large Debts	Inadequate managerial skills	Poor Government Policies	Competition	Lending Rates
Pearson Correlation	Financial Distress	1.000	.336	.224	-.052	.056	.256	-.051	.272
	Inadequate Capital		1.000	.054	-.285	.115	.138	.290	.113
	Poor Succession			1.000	-.079	.568	-.107	-.114	.038
	Large Debts				1.00	.054	-.227	-.187	.217
	Inadequate managerial skills					1.000	-.100	-.090	.065
	Poor Government Policies						1.000	-.144	.012
	Competition							1.000	.029
	Lending Rates								1.000

Source, Author, 2018

The finding in the table above the Pearson correlation coefficient between financial distress and Inadequate Capital is 0.336 meaning that there is a moderate positive correlation. Pearson correlation coefficient between financial distress and Poor Succession Planning and governance is 0.224 indicating moderate positive correlation. There is a weak negative correlation between financial distress and Large Debts and

competition at -0.052 and -0.051 respectively. A weak positive correlation exists between financial distress and poor governance and lending rates at .256 and 0.272.

4.6 Test of Multicollinearity

Multicollinearity occurs when there is high intercorrelation among independent variables. This correlation is a problem because independent variables should be independent. Multicollinearity is measured using the Variance Inflation Factor (VIF) as well as the levels of tolerance. Low tolerance levels are an indicator that there is a linear relationship between the variables and thus they should not be included in the regression model. Low tolerance levels of say 0.2 are considered an issue of concern because they indicate that 80% of the variance of the independent variables are shared with some other independent variable. VIF should be higher than 1 and less than 10. Values higher than 10 are an indicator of Multicollinearity.

Table 6: Multicollinearity

		Collinearity Statistics	
Model		Tolerance	VIF
1	(Constant)		
	Inadequate Capital	.797	1.254
	Poor Succession Planning and governance	.646	1.547
	Large Debts	.771	1.297
	Inadequate managerial skills	.651	1.537
	Poor Government Policies	.864	1.158
	Competition	.826	1.210
	Lending Rates	.912	1.097

Source, Author, 2018

The study provides tolerance levels of between 0.646 and 0.912 which are high indicating that Multicollinearity does not exist. Further, the VIF for the data lies between 1.254 for

inadequate capital and 1.097 for lending rates indicating a lack of Multicollinearity. It is an indicator that all the variables are useable in the regression model.

4.7 Regression Analysis

The regression analysis is a statistical tool that allows the researcher to establish the relationship between the variables of interest in the study. A study of the regression model indicates the relationship between the independent and the dependent variables.

4.7.1 Model Summary

Table 7: Model Summary

Model Summary

					Change Statistics				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change	F Change	df1	df2	Sig. F Change
1	.536[a]	.288	.218	.541	.288	4.098	7	71	.001

a. Predictors: (Constant), Lending Rates, Poor Government Policies, Poor Succession Planning and governance, Inadequate Capital, Competition, Large Debts, Inadequate managerial skills

Source, Author, 2018

The model summary provides an r squared of 28.8% which is an indication that the variables under the study determine up to 28.8% of financial distress in SMEs. It is an indication that many other variables influence financial distress in SMEs in Nairobi County other than those discussed in the study.

4.7.2 Analysis of Variance

The analysis of variance (ANOVA) is an indication of whether the study findings are significant. It is an analysis that enables the researcher to establish whether to accept or

reject the null hypothesis. ANOVA is established by looking at the significance level is less than 0.05 then the results are significant.

Table 8: ANOVA

ANOVA

		Sum of Squares	df	Mean Square	F	Sig
Between People		81.367	78	1.043		
Within People	Between Items	113.897	7	16.271	20.089	.000
	Residual	442.228	546	.810		
	Total	556.125	553	1.006		
Total		637.492	631	1.010		

Source, Author, 2018

The study was done at a significance level of 5% which is 0.05 and produced a p-value of 0.000 meaning that we reject the null hypothesis and conclude that inadequate capital, Poor Succession Planning and governance, Large Debts, inadequate managerial skills, Poor Government Policies, Competition, and lending rates have an effect on financial distress in an organization.

4.7.3 Coefficients of Determination

The regression analysis in the study in the study was established through a questionnaire that used a 5-point Likert Scale to determine the causes of financial distress on Small and Medium Enterprises in Nairobi County with a focus on inadequate capital, poor

succession planning, inadequate managerial skills, poor governance policies, competition and lending rates. The findings of the relationship are as per the table below:

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients			95.0% Confidence Interval for B		Collinearity Statistics	
		B	Std. Error	Beta	T	Sig.	Lower Bound	Upper Bound	Tolerance	VIF
1	(Constant)	2.288	.543		4.215	.000	1.206	3.371		
	Inadequate Capital	.280	.097	.323	2.881	.005	.086	.474	.797	1.254
	Poor Succession	.185	.075	.308	2.471	.016	.036	.334	.646	1.547
	Large Debts	.033	.062	.060	.528	.599	-.091	.156	.771	1.297
	Inadequate managerial skills	-.100	.078	-.159	-1.279	.205	-.256	.056	.651	1.537
	Poor Government Policies	.131	.062	.227	2.106	.039	.007	.256	.864	1.158
	Competition	-.074	.095	-.087	-.788	.434	-.263	.114	.826	1.210
	Lending Rates	.138	.065	.220	2.101	.039	.007	.268	.912	1.097

a. Dependent Variable: Financial Distress

Table 9: Regression Analysis

Source, Author, 2018

The relationship between financial distress and the causes of distress is expressed through a linear equation of the form illustrated below;

$$\mathbf{Y_{\mathit{i}} = 2.288 + 0.28X_1 + 0.185X_2 + 0.131X_3 + 0.138X_4}$$

2.288 =constant which indicates that if all the variables in the study are held constant financial distress would change by 2.288

$\mathbf{Y}_i$ = Financial Distress which is the dependent variable influenced by the independent variables below.

$\mathbf{X_1}$= 0.28 =Inadequate Capital. Meaning that if inadequate capital increases by 1-unit, financial distress increases by 0.28

$\mathbf{X_2}$= 0.185 = Poor Succession Planning and governance. Meaning that if poor succession and planning increases by 1-unit, financial distress increases by 0.185

$\mathbf{X_3}$ = 0.131= Poor Government Policies. Meaning that if Poor Government Policies increase by 1-unit financial distress increases by 0.131

$\mathbf{X_4}$ **= 0.138 =** Lending Rates. Meaning that if Lending Rates increase by 1-unit financial distress increases by 0.138

The study was done at a significance level of 5% which is 0.05. The p values for the variables are .005 for inadequate capital, .016 with Poor Succession Planning and governance, .599 with Large Debts, .205 with inadequate managerial skills, 0.039 with Poor Government Policies, 0.434 with Competition, and .039 with lending rates.

The findings, therefore, indicate that there is a significant relationship between financial distress and inadequate capital, poor succession planning and governance, poor government policies and lending rates. There is, however, an insignificant relationship between financial distress and large debt, managerial skills, and competition.

4.8 Discussion of Research Findings

The study objective was to understand the causes of financial distress on Small and Medium Enterprises in Nairobi County. The study was done with a focus on inadequate capital, poor succession planning, and governance, large debts, inadequate managerial skills, poor government policies, competition and lending rates. Data collection was done

through a questionnaire to 100 SMEs located in Nairobi County where 79 SMEs successfully filled and returned the questionnaires. The study findings indicated that inadequate capital, poor succession planning and governance, poor government policies, and lending rates have a significant effect on financial distress in an organization. There is, however, an insignificant relationship between financial distress and large debt, inadequate managerial skills, and competition.

The study was done based on the credit risk theory which stipulates that credit risk is the risk that a lender faces when the borrower fails to make the required payment. Although not all SMEs operate by acquiring goods on credit, a firm under financial distress is most likely to default on maturing obligations, and that's why this assertion is essential. The study findings indicate that lending rates have a significant effect on financial distress which is key to influencing the credit risk. However, large debt was found to have an insignificant effect. It is possible that SMEs do not borrow large debt, but their credit is based on small financial obligations.

The cash management theory by Mao & Sarndal (1978) cash management is keen on a firms' liquidity. The theory posits that every firm should ensure corporate cash balances are appropriately managed. The study found that inadequate managerial skills have a positive impact on financial distress and though the relationship may be insignificant, inadequate management skills have the likelihood of leading to poor planning, and that quickly lead to financial distress in the organization.

The entropy theory enables analysts to identify firms undergoing distress by observing the changes occurring in their balance sheet. However, the theory has its weakness as it focuses only on the changes occurring in the balance sheet structure not considering the

reason behind the change (Aziz & Dar, 2006). The study was keen to understand other factors other than balance sheet indicators that affect the success of SMEs.

Poor succession planning and governance were seen to have a significant impact on financial distress. The findings support the findings by Galloway & Jones (2006) who established that companies that failed to plan and prepare on matters of succession by training people taking up key positions in companies faced financial distress over a period.

In the empirical review, Jahur and Quadir (2012) established that fund mismanagement could be as a result of a lack of managerial skills employment of poor accounting systems or mismanagement of funds. The study findings indicate that inadequate managerial skills have a positive impact on financial distress. It means that the management of the organization needs to acquire the crucial skills that ensure that the organization remains sustainable and not fall into financial distress.

Ombongi & Long (2018) established that bank loans affect the financial performance of SMEs positively or adversely. The study supports the findings by showing that lending rates have a significant impact on the levels of financial distress in an organization. SMEs managers should try not to load the business with more loans than their capacity to pay (Kanugi & Gichira, 2017). The study found that large debt has no significant impact on the levels of financial distress in an organization of SMEs.

The findings of the study support the study by Mwangi (2017) who established that the leading causes of financial distress for SMEs were rapid changes in technology, limited market access, insufficient capital, inadequate knowledge and skills, and poor

infrastructure. Also, corruption and government regulations with regards to matters of tax and imports provided other bottlenecks to financially distressed SMEs in Kenya.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The chapter summarizes results of prior chapters and presents conclusions drawn from the study findings. It also highlights the encountered shortcomings during the course of the study. The chapter also makes policy recommendations, which should be executed to attain high financial performance of SMEs by avoiding distress. Finally, the chapter shows suggestions for future research studies, useful for future scholars.

5.2 Findings Summary

The study objective was to understand the causes of financial distress on Small and Medium Enterprises in Nairobi County. The findings of the study indicate that there is a significant relationship between financial distress and inadequate capital, poor succession planning and governance, poor government policies and lending rates. There is, however, an insignificant relationship between financial distress and large debt, managerial skills,

and competition.

If inadequate capital increases by 1 unit, financial distress increases by 0.28, if poor succession and planning increases by 1 unit, financial distress increases by 0.185, if large debts increase by 1 unit financial distress increases by 0.033, if inadequate managerial skills and accounting systems increase by 1 unit financial distress decreases by 0.100, if poor government policies increase by 1 unit financial distress increases by 0.131, if Competition increase by 1 unit financial distress decreases by 0.074, and if lending rates increase by 1 unit financial distress increases by 0.138.

Inadequate capital, poor succession and planning, poor government policies, large debts and lending rates have a positive relationship with financial distress. These are areas that SMEs need to focus on to ensure that they remain sustainable in the face of growth.

The study findings indicate that if competition increases by 1 unit financial distress decrease by 0.074. It may be an indication that competition in SMEs may be a good tool to ensure business provide quality services to clients. Further, is inadequate managerial skills and accounting systems increase by 1-unit financial distress decreases by 0.100. It may be an indication that management and accounting systems may not be the key driving force to the success of SMEs.

5.3 Conclusion

The study sought to address the research objective of determining the causes of financial distress in SMEs in Nairobi County. The study concludes that there is a strong relationship (R= 0.536) between financial distress and causes of financial distress in SMEs in Nairobi County. Consequently, variables under the study determine up to 28.8% of financial distress in SMEs.

The study also concludes that that inadequate capital, poor succession planning and governance, large debts, inadequate managerial skills, poor government policies, competition and lending rates have an effect on financial distress in an organization.

However, inadequate capital, poor succession planning and governance, poor government policies and lending rates led to financial distress to a great extent. However managerial skills, large debts and competition have an insignificant effect on financial distress. Therefore, the presence of skilled management in a firm does not always translate to the

success of the firm. Consequently, the presence of large debts in a firm and competitors do not always lead to financial distress.

5.4 Recommendations

In Kenya, SMEs play an important role in the country's economic growth and development. Therefore, the causes of financial distress among SMEs need to be identified and solved. Government policies have been seen to have a significant effect on financial distress. Therefore the government needs to create policies that enhance the value of SMEs. In addition, the government should also create a business environment that enhances SMEs growth.

Few SMEs keep good financial records; therefore, they are not able to meet banks qualifications for debt financing leading to financial strain. It means that SMEs are constantly going to fall into financial distress. The study makes the recommendation that SMEs use technology to manage their records to ensure that they can easily be audited and therefore access credit. Consequently, SMEs should hire skilled accountants for bookkeeping to enhance the quality of financial records kept.

Poor succession planning and governance were seen to have a significant impact on financial distress. SMEs fail to separate the entrepreneur from the manager when the business evolves. The entrepreneur therefore, lacks skills needed to operate within the new business dynamics leading to uninformed decision making and later financial distress. SMEs also rarely make plans for persons that takes over operations. They operate on a day to basis with minimal training of people that could take over the business. The study makes the recommendation that SMEs put down plans that ensure

that there are people that understand all the operations of the organization and can easily run the business and ensure its sustainability.

SMEs managers should try not to load the business with more loans than their capacity to pay (Kanugi & Gichira, 2017). The study makes the recommendation that SMEs need to understand their capacity and their business needs before taking up additional loans that would otherwise lead to financial distress.

5.5 Limitations of the Study

The study is limited through the use of a sample of 100 SMEs in Nairobi County to generalize all the SMEs. The use of samples may not always entirely be a good representative given the dynamic nature of the SMEs. A longer study using a larger sample is more reliable as it will take into account more SMEs not accounted for in the study.

The researcher also found it difficult to obtain data since most SMEs do not maintain financial records and the study had to be done through a questionnaire done through a Likert scale. This explains why the researcher was only able to obtain data from 79 SMEs out of a possible 100. Therefore, the use of qualitative data may not be a true reflection of the financial distress position of an organization.

Another limitation was the quality of data. It is illusion to derive conclusions from the study since the legitimacy of the situation cannot be ascertained. The data that has been used is only assumed to be accurate. The measures used may keep on deviating from individual to individual. The use of the Five point Likert scale fails to measure the true

attitudes of respondents. Consequently, some respondents may shy from giving the right information for fear of being seen as extremist.

For data analysis purposes, the researcher applied the regression model. Due to the shortcomings involved when using regression models such as erroneous and misleading results when the variable values change, the researcher cannot be in a position to generalize the findings with certainty. If more and more data is added to the functional regression model, the hypothesized relationship between two or more variables may not hold.

5.6 Suggestions for Further Research

Poor succession planning and governance was seen to have a significant impact on financial distress. The study suggests studying into the level to which SMEs have incorporated succession planning into their operations and the impact that it has on its financial performance.

Cash management deals with the optimal use of available cash, maximum utilization of interests earned by extra funds not required immediately and reduction of losses caused by delays in fund transmission. The study recommends further study into understanding the impact of cash management on the sustainability of SMEs in Nairobi County.

The study limited itself by focusing on SMEs in Nairobi County. The recommendations are that further studies be conducted on SMEs in other counties. Finally due to the short comings of regression models, other models such as the Vector Error Correction Model (VECM) be used to explain the various relationships between variables.

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APPENDICES

Instructions

Please place a tick (√) in the appropriate box.

Part 1: General Questions

1. Name of SME……………………………………………………….
2. Please indicate gender

   Female [ ]

   Male [ ]
3. Indicate your level of education

   Primary [ ]

   Secondary [ ]

   Diploma [ ]

   University [ ]
4. How long have you worked in this organization?

   Less than 4 [ ]

   4-8 [ ]

   8-12 [ ]

   Above 12 [ ]

Part 2: Endogenous Variables

1. Does the organization maintain books of accounts?

   Yes [ ]

   No [ ]

2. Does your organization have an accounting information system?

   Yes [ ]

   No [ ]

3. Who maintains financial records?

   Self [ ]

   Outsourcing [ ]

   Company accountant [ ]

4. How do you raise your finance

   Friends [ ]

   Microfinance institutions [ ]

   Banks [ ]

5. Have you ever accessed credit from a financial institution?

   Yes [ ]

   No [ ]

   If yes what kind of loan

   Secured [ ]

   Unsecured [ ]

Part 3: Financial Distress

To what extent do you agree with the following statements on financial distress and determinants of financial distress in your SMEs? Rate on a scale of 1 to 5 1= To a very great extent 2 = To a great extent 3 = To a moderate 4 = To a low extent 5 = To no extent at all

Statement	1	2	3	4	5
We are able to pay company bills in a timely manner					
We have been able to pay the employees in a timely manner					
We have retained earnings to sustain the SME for six months					
We suffer from lack of cashflows from time to time					

Part 4: Inadequate capital

Statement	1	2	3	4	5
We have adequate capital for expansion					
We have been able to acquire credit with ease					
Lack of capital has led to stock out in the business					
Inadequate capital has led to loss of viable business opportunities					

Part 5: Poor succession planning and governance

Statement	1	2	3	4	5
We have trained people to run the business in future					
We have a strategy to run the business for atleast 5 years					
I have seen business fail on death of owner					
There are proper governance policies in the SME					

Part 6: Poor government policies

Statement	1	2	3	4	5
Policies on taxes have been seen to hinder business					
Policies on payment of work permits hinder business					
Policies on quality standards hinder business success					
Policies in business locations hinders business success					

Part 7: Lending rates

Statement	1	2	3	4	5
We have been unable to borrow due to interest rates					
We have run into financial distress due to need to pay loan interests					
Bank lending rates are too high for SMEs					
Lending rates create a burden in the books of SMEs					

Part 8: Large Debt

Statement	1	2	3	4	5
We have borrowed funds above Kes 2M					
Banks easily grant large loans to SMEs					
We have adequately borrowed and repaid large loans					
Banks consider large loans a risky investment for SMEs					

Part 9: Inadequate managerial skills and accounting systems

Statement	1	2	3	4	5
We have adequate managerial skills on cash management					
There is adequate managerial skills to manage debt levels					
There is adequate managerial skills to prevent business liquidity					
We have adequate accounting systems to monitor business progress					

Part 10: Competition

Statement	1	2	3	4	5
There is unfair competition in the market					
Competition enhances innovation in the market					
Competition has led to the fall of many SMEs					
Competition leads to loss of customers and hence financial distress					