

Effect Of Financial Management Practices on Financial Performance of Small and Medium Enterprises in Kiambu Town, Kenya

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Abstract:

Financial management is an important element of the management of any business. This study was therefore, designed to establish the effect of financial management practices on financial performance of small and medium enterprises in Kiambu town in Kenya. Three variables namely Working Capital Management, Investment decisions and financing decisions [independent variables] were used to measure financial performance [dependent variable]. The study used descriptive research design utilizing qualitative data captured using a self-administered questionnaire. The study showed that considered individually, there is a positive relationship between working capital management; investment decisions; financial decisions and financial performance. The study showed that the combined effect of financial management practices [working capital management, investment decision, financial decision] have a moderate positive relationship between financial management practices and financial performance. The study recommends that to enhance financial performance, the organizations [SMEs] should adopt credit policies to guide credit sales. The policies should create a balance between customer retention and adequate the cash flow. Secondly the study recommends that the government should ensure creation of favourable policy and economic environment through legislation that facilitate access to affordable sources of funding for SMEs and attract venture capitalist. Third, developing appropriate strategies and policies that enhance financial decisions will be critical for the SMEs in enhancing their financial performance. Fourth, a study that covers other parts of the country with unique business environments would be welcome.

Key words: Financial Management practices, Financial Performance, (SMEs).

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Financial management is an important element of the management of any business. It is a key part of the management function focusing on the management of a business' assets. In the long term, the type of assets owned by a business charts out the direction of that business during the life of these assets. A business might not see its long term if it cannot carefully plan and lay out a policy to effectively manage its finances. As a result, ineffective financial management altogether is the main cause of the underlying problems facing Small and Medium Enterprises (SME) financial management (Jindrichovska, 2003).

Many, if not all of those who start a business do not engage themselves in financial matters. This is because they do not have enough knowledge about recording transactions, preparation and analysis of financial statements. Sometimes they get deeply engrossed in other aspects of business like managing people, sales purchasing and production to have any interest in carefully managing finances. Such entrepreneurs end up relying on their accountants to run the financial side of their business. Otherwise, they decide to do the management themselves making the business vulnerable to collapse (Atic, 2010).

Financial Management is about planning, organizing, directing and controlling the financial activities in a firm. Such activities involve the procurement and utilization of funds of the enterprise. Financial management refers to the application of general management principles to financial resources of the enterprise (Weston and Brigham, 1996).

According to (Gitman, 2000), other than application of management principles to financial resources, financial management deals with financing decisions and investment decisions. Financing decisions relate to whether a firm needs financing and how the financing will be done. Financial management is about identifying various sources of finance and how much needs to be raised from each of the sources. The sourcing will depend on the type of source, period of financing, cost of financing and the expected returns.

Investment decisions are also called capital budgeting and include investment in fixed assets. Investment in current assets is also a part of investment decisions called as working capital decisions. The finance manager of

any firm has the responsibility of carefully selecting the best investment alternatives in order to achieve reasonable and stable returns. The finance manager has to concentrate on safety, liquidity and profitability while investing capital. This is also to be done with the aim of wealth maximization (Singh, 2007).

In Europe, despite the sometimes challenging economic conditions, SMEs have retained their position as the backbone of the European economy. By 2012, there were some 20.7 million SMEs accounting for more than 98 per cent of all enterprises. 92.2 per cent of the SMEs were the small ones with less than ten employees. These SMEs accounted for 67 per cent of total employment (Wymenga et al., 2012).

In the East Asian region there is the dominance of the SMEs sector all the region's economies. Despite the different levels of development in the countries, the broad challenges faced by these East Asian SMEs are similar. Other than financial management challenges, the SMEs face other challenges like globalization, technological innovation, demographic and social change, as well as limited financial support (Chia, Fu and Lee, 2007).

According to Ong'olo and Odhiambo (2013) SMEs have the capacity to spur rapid economic growth and create employment opportunities in Kenya. It is estimated that SMEs create about 85 percent of Kenya's employment. However, the sector contributes only about 20 percent of the total Gross Domestic Product. This means the SME subsector is recording dismal performance. For the sector to realize higher success levels, there has to be effective financial management or else the dismal performance and the frequent collapse of SMEs will persist.

SMEs in Kenya operate in all sectors of the economy, that is, manufacturing, trade and service subsectors. The SMEs range from those unregistered, known as Jua Kali enterprises, to those formally registered small-scale businesses, such as supermarkets, wholesale shops and transport companies. The capital invested in SMEs varies from as little as ten thousand Kenyan shillings to about 5 million Kenyan shillings. Almost two-thirds of all SMEs in Kenya are located in the rural areas with only one-third found in the urban areas (Central Bureau of Statistics, 2009).

1.2 Statement of the Problem

The Small and Medium Enterprises (SMEs) play an important role in the Kenyan Economy. This sub-sector contributed over 50 percent of new jobs created in the year 2005 (The Economic Survey, 2006) and contributes about 20% of GDP. Despite their significance, past statistics indicate that three out of five SMEs fail within the first few years of operation (Kenya National Bureau of Statistics, 2007). According to Ong'olo and Odhiambo (2013) the subsector is still performing dismally.

Because of their small size, simple management mistakes lead to the collapse of SMEs. Lack of proper financial management is one of the issues that easily lead to the collapse of SMEs despite improved access to financing (Longenecker, et al., 2006). If interventions regarding how these SMEs conduct financial management is not addressed, their collapse will not only threaten job creation and entrepreneurship, but will impede economic growth and development. This research sought to find out how the SMEs conduct their financial management and how the practices affect their financial performance. This enabled provision of recommendations on remedial measures. To achieve this, the researcher conducted a survey focusing on SMEs located in Kiambu town in Kiambu County.

1.3 Purpose of the study

To establish the effect of financial management practices on financial performance of small and medium enterprises in Kiambu Town in Kenya.

1.4 Objectives of the study

The following were the objectives of this research regarding Small and Medium Enterprises in Kiambu town.

- i. To assess the effect of working capital management on the financial performance of Small and Medium Enterprises in Kiambu town.
- ii. To find out how investment decisions contributes to financial performance of Small and Medium Enterprises in Kiambu town.
- iii. To examine the effect of financing decisions on the financial performance of Small and Medium Enterprises in Kiambu town.

1.5 Research Questions

The following are the research questions this study sought to answer.

- i. What is the effect of working capital management on the financial performance of Small and Medium Enterprises in Kiambu town?
- ii. What is the contribution of investment decisions towards the financial performance of Small and Medium Enterprises in Kiambu town?
- iii. How does financing decisions affect the financial performance of Small and Medium Enterprises in Kiambu town?

1.6 Significance of the Study

This research is significant to the owners of SMEs in Kiambu town, policy makers in the government of Kenya and financial management researchers. The owners of SMEs in Kiambu and elsewhere will get information concerning how best to finances in their businesses to improve the financial performance of their businesses. This is an input that can be used to come up with methods of improving the financial efficiency and profitability of the SMEs.

Policy makers will use the information obtained from this research for their policy formulation concerning financial management of SMEs. The research highlighted the relationship between the financial management and financial performance of SMEs. This relationship indicated the importance of financial management as a contributor to financial performance of SMEs.

Research concerning the contribution of financial management on financial performance of SMEs in Kiambu town is rare, if available at all. This research provides a scholarly contribution to the effect of financial management in SMEs with focus on Kiambu town. Future researchers will, therefore, use the findings of this study to further arguments and future research projects that will find this research relevant.

1.7 Scope of the Study

First this research did not cover all the SMEs in Kenya in their varied nature. It only focused on SMEs in Kiambu Town. The study limited itself to finding out the effects of working capital management, investment and financing on financial performance of the SMEs in Kiambu town.

1.8 Limitations of the Study

This research was expected to have several limitations. Being a survey, the findings would be as true as the time when the data was collected. Therefore, findings may not be applicable to later times. Secondly, the data required for the research was qualitative indicating the possible influence of opinions and attitudes of the respondents. Focusing on SMEs in Kiambu town only, the findings may not be applicable to the whole country. To address limitations the study had three approaches. First, the sampling was as much as possible to replicate the distribution of SMEs in Kiambu town according to the industries they serve and the sizes. Secondly, to address the issue of opinions, the researcher only focused on the owners of the SMEs which are likely to give the most accurate information concerning their businesses. Finally, the construction of the questionnaire was such that it was not only simplified, but there was reduced variation of the responses from the respondents by applying closed ended questions.

1.9 Assumptions of the Study

This research assumed that financial management practices significantly contribute to the financial performance of SMEs in Kiambu town. It also assumed that the owners of SMEs have strategies they use to manage finances in their businesses. Further, the researcher assumed that the owners of the SMEs in Kiambu would be willing to provide the information required for this study and that the information they provided would be accurate.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

Financial management in SMEs can be explained using various theories. Further, research findings on how various aspects of financial management affect a firm's financial performance vary. This chapter discusses three theories on financial management and reviews literature on how working capital management, investment

decisions and financing decisions affect the financial performance of a firm. The chapter also identifies the research gap.

2.1 Financial Management

In this discussion, financial management is looked at in terms of Working capital management (WCM), investment decisions and financing decisions. Working capital refers to a firm's short-term assets or current assets. Management of working capital refers to the daily activity that ensures a firm has sufficient resources to continue its operations. Working capital management refers to all activities related to the firm's receipt and disbursement of cash (Lieberman, 2009).

The main focus of WCM is steering the firm through challenges such as disconnected supply chain processes, excessive stocks caused by non-bridged interfaces, inadequate trade credit terms, and suboptimal loan decisions. While inadequate trade credit terms and suboptimal loan decisions originate from the financial area, connecting supply chain activities and reducing stock and inventory belong to the operating area. Organizations tend to try as much as possible to have less capital tied up in non-productive stocks, try to shorten the collection period for account receivables, and stretch cash payments for accounts payable as far as possible (Hofman, 2010).

Effective WCM is, therefore, a key role in maintaining the financial health of a firm. Management of Short-term finance is an essential part of working capital management. This is because Working capital is the only investment a company makes without expecting a defined return. If a firm over-invests in working capital it is likely to run into cash flow problems and may collapse (Hofman, 2010).

Investment decision is about firms deciding how to invest their capital in available projects. These decisions include which new projects to consider, how much to be invested in chosen projects and whether or not to acquire other firms. The eventuality of the investment decision process is the definition of the set and size of a firm's real assets. This composition and size of the firm's assets is used to generate the cash flows that determine its profitability, value, and viability (Graham and Harvey, 2001).

Financing decisions is about deciding on the capital structure of a firm. The owner of a firm has to decide when, where and how to acquire funds to meet investment needs. The key issue is determining the proportion of equity and debt. The mix of debt and equity is known as the firm's capital structure. The financial manager must obtain the best financing mix for the firm, that is, the mix where the market value of the firm is maximized. Once the financial manager has determined the best combination of debt and equity, the appropriate amounts should be raised through the best available sources (Baker and Martin, 2011).

2.2 Theoretical Review and Theoretical Framework

2.2.1 Pecking order theory

This is a theory suggested by Myers and Majluf (1984) and Myers (1984) to explain how firms seek financing. According to the theory, firms seeking to finance new investments prefer to use funds according to some hierarchy. A firm will first use internal funds, then debt issuance, and finally equity issuance. The pecking order arises because owners, who want to avoid diluting existing shareholders' claim, will issue only overvalued securities.

This theory can be used to explain how SMEs decide to choose where to get funds from. According to the pecking order, they are likely to start with the cheaper sources of financing before going to the more expensive ones. This is in the desire to minimize the cost of capital which can become a major cost that will reduce profitability and general financial performance

2.2.2 Financial Theory of Investment

The financial theory of investment was proposed by Minsky (1986). In simplified terms this theory links financial market fragility, in the normal life cycle of an economy, with speculative investment in financial markets. According to this theory, during prosperous times, corporate cash flow rises beyond what is needed to pay off debt, and a speculative euphoria develops. Soon after, debts exceed what borrowers can pay off from their incoming revenues. This then turns into a financial crisis. As a result of such speculative borrowing risk, banks and lenders tighten credit availability.

This theory suggests that the use of debt to finance investment depends on the market cycles. When the market is performing well, there is excess cash flow which makes credit easily available. This makes businesses to

borrow. However, as the performance of the market becomes riskier due to excess borrowing, lenders tightly control lending. This relationship between debt financing and investment can be used to explain how SMEs manage their working capital.

2.2.3 Just In Time Model

Just in Time (JIT) production is a manufacturing philosophy whose aim is eliminating waste associated with time, labor, and storage space. The approach was first used by Ford Motor Company during 1920s in the United States of America before being subsequently adopted and publicized by Toyota Motor Corporation of Japan. The basic tenets of the JIT are that a company produces only what is needed, when it is needed and in the quantity that is needed. A company produces only what the customer requests, to actual orders, not to forecast (Liker, 2004).

This model suggests that a SME should produce only what customer's need, in amounts they need and at the time they need it. For SMEs in trade, they only need to stock what customer's need, at the time they need it and in the actual needed quantities. If this happens, then the losses that occur due to inaccurate estimation of inventories and other current assets will be eliminated leading to improved financial performance.

2.3 Financial Performance

Financial performance is the act of performing a financial activity. It refers to the degree to which financial objectives of an organization are being or have been met. Financial performance is also used to measure a firm's overall financial health over a given period of time. Financial performance is done with the help of financial analysis of a firm (Horngren, et. all. 2011).

When assessing the financial performance of any firm, four areas are focused on. These are: working capital analysis, financial structure analysis, activity analysis and profitability analysis. The analysis is done in two dimensions. The dimension of material used and the dimension of the mode of operation. In the material used dimension, analysis is done internally or externally. Internal analysis involves executives and employees of the organization or any other persons who have access to the books of account and other internal information related to the business. The external analysis involves outsiders of the business such as investors, credit agencies, government agencies, and other creditors who have no access to the internal records of the company, but rely on published records (Metcalf and Titard, 1976).

The dimension of the mode of operation involves horizontal or vertical analysis. Horizontal analysis involves analyzing and reviewing financial statements for a number of years. Current figures are compared with those of a base year. In the vertical analysis quantitative relationship of the various items of financial statements on a particular date form the basis of analysis are used to compare with other organizations of the same type (Schonbohm, 2013).

2.4 Empirical Review

2.4.1 Working Capital Management and Financial Performance

A study by Charitou et. al. (2010) investigated the effect of working capital management on firm's financial performance in an emerging market. The hypothesis of the study was that working capital management leads to improved profitability. They used data of companies listed in the Cyprus Stock Exchange for the period 1998-2007. They used multivariate regression analysis to conduct data analysis. From the analysis they confirmed the hypothesis that working capital management leads to improved profitability. Specifically they found that the cash conversion cycle and all its major components such as days in inventory, day's sales outstanding and creditors payment period were closely linked to the firms' profitability.

Kirui (2013) also conducted a study to investigate how working capital management practices effect financial performance of sugarcane out-grower companies in Kenya. The research employed a descriptive approach. From ten sugarcane out-grower companies, a total of 30 managerial staff responded to a standardized semi-structured questionnaire. Descriptive statistics and correlation analysis were used to analyze the responses. It was established that most sugarcane out-grower companies more conservative in WCM and this weakened the companies' financial performance. For instance, the companies' receivables were concentrated on loans advanced to members and accruing interests. However, trade receivables period was longer than payables period, indicating that the companies did not accelerate receivable periods to secure profitability.

In another study Mwangi et al. (2014) investigated the effect of working capital management on the performance of non-financial companies listed in the Nairobi Securities Exchange (NSE) in Kenya. This was an exploratory research. It was done on all the 42 listed non-financial companies. Secondary panel data from the annual audited reports and financial statements of the listed non-financial companies for the period 2006-2012 were used. The Feasible Generalized Least Square (FGLS) model was used to analyze the data and revealed that an aggressive financing policy had a significant positive effect on return on assets and return on equity. A conservative financing policy also had a significant positive effect on financial performance. The study recommended adoption of either aggressive or conservative financing policy to enhance the performance of the listed non-financial companies.

2.4.2 Investment Decisions and Financial Performance

Heshmati and Loof (2008) conducted an empirical analysis to establish whether there exists a two-way causal relationship between investment and a firm's financial performance using Swedish firms' data between 1992 and 2000. The variables of financial performance included sales, value added, profit, cash flow and capital structure. The investment variables were research and development and physical capital. The study applied a multivariate vector auto-regressive approach. Results showed two-way causal relationships. This meant investment decisions determined financial performance while financial performance, too, determined investment decision.

Salazar, et al. (2013) examined how the financial decision made by companies, their strategies, the alignment between financial decisions and strategies affected the level of competitiveness of the companies. The study was done on 202 businesses in the region of Celaya, Mexico in which the data were collected using a questionnaire. The results show that most micro and small enterprises made funding decisions in a similar way, they used an intensive strategy, had low market longevity and had regular sales levels. This indicated lack of competitiveness, which hampers their development and expansion. The emphasis that the companies placed on certain financial decisions was not always appropriate for the type of business strategy being implemented. The study concluded that companies that efficiently manage their short-term assets and liabilities were more competitive and had greater longevity in the market.

Kamunge, et al. (2014) sought to establish the factors that determine the performance of small and micro enterprises (SMEs) traders at Limuru town market in Kiambu County, Kenya. The study employed a descriptive study design. The study collected data from 274 of the 965 licensed SMEs using a self-administered questionnaire. Analysis revealed that access to finance and financial management experience are the key factors affecting the performance of the businesses.

2.4.3 Financing Decisions and Financial Performance

Karanja (2014) conducted a study to establish the effect of capital structure on financial performance of SMEs in dairy sector in Kiambu County. The research was a causal study to find out whether capital structure was a predictor of financial performance in the SMEs under study. Data from 50 the 71 SMEs were used. The secondary data used in the research was obtained from the SMEs annual reports and newsletters. The multivariate regression and correlation analysis revealed that debt equity ratio was a significant cause of financial performance. Debt equity ratio and liquidity ratios also had significant effect on financial performance. The general finding was that capital structure affected financial performance.

A study by Chepkemoi (2013) aimed at analyzing the effect of capital structure on the financial performance of SME in Nakuru Town of Nakuru County. The study assessed the effects of a SMEs' capital structure on profitability, liquidity and sales growth. 170 of the targeted 295 SMEs made the sample. Secondary data was collected from financial records of SMEs were used. Descriptive statistics such as mean and standard deviation and inferential statistic such as Pearson correlation and multiple regression models were used to analyze data. The findings revealed that capital structure had negative effect on firm profitability, positive effect on firm liquidity and positive effect on sales growth.

In another study Raza (2013) used panel data analysis to find the determinants of capital structure of non-financial firms listed on the Karachi Stock Exchange for the period 2004-2009. Using descriptive statistics the study found the highest leverage ratio in textile industry but the average profitability of textile industry was

negatives. This made them conclude that leverage had a negative relationship with financial performance. High leverage results to low profitability.

2.5 Research Gap Analysis

The literature review theories indicate that WCM, investment decisions and financing decisions as variables of financial management are closely related to the financial performance of a firm. However, the findings vary. For instance, though the study by Charitou, et. all. (2010) found a close connection between WCM and financial performance, the findings did not reveal whether the relationship is positive or negative. The study by Mwangi, Makau and Kosimbei (2014) established that the more aggressive a firm became, the more the better the financial performance.

The study by Salazar, et.al, (2013) found that companies with efficient management their short-term assets and liabilities were more competitive and had greater longevity in the market. The other study by Kamunge, et. al. (2014) found that financial performance of SMEs was affected by financial management among other factors but did not show how the financial management affected the financial performance. Raza (2013) established that financing decision affected financial performance by way of increased leverage reducing profitability of listed companies in the textile industry in Karachi. None of the reviewed studies have sought to explain how WCM, investment decisions and financing decisions affect the financial performance of SMEs in Kiambu town. This is the gap that this study will fill.

2.6 Conceptual Framework

Figure 1.1 below presents the conceptual framework guiding this research. The research has three independent variables that will be used to measure financial management. These three variables are working capital management, financial decisions and investment decisions. The dependent variable is financial performance measured by sales volume, asset growth and profit.

The intervening variables include management skills, ownership, business objectives, business risk environment and financial market development. The management skills will determine how the independent variables affect financial performance. If there are effective management skills and approaches, the independent variables will definitely lead to improved financial performance. The ownership of the SMEs will determine the objectives they set and, therefore, the effectiveness of management. The objectives they set and how they relate with the management will determine financial performance. The business risk environment will determine the nature of operations to avoid those risks and this will affect the financial performance. The development of the financial market will determine the access to finance for the SMEs. Availability of finance makes operations smoother leading to better performance as opposed to when finance is scarce.

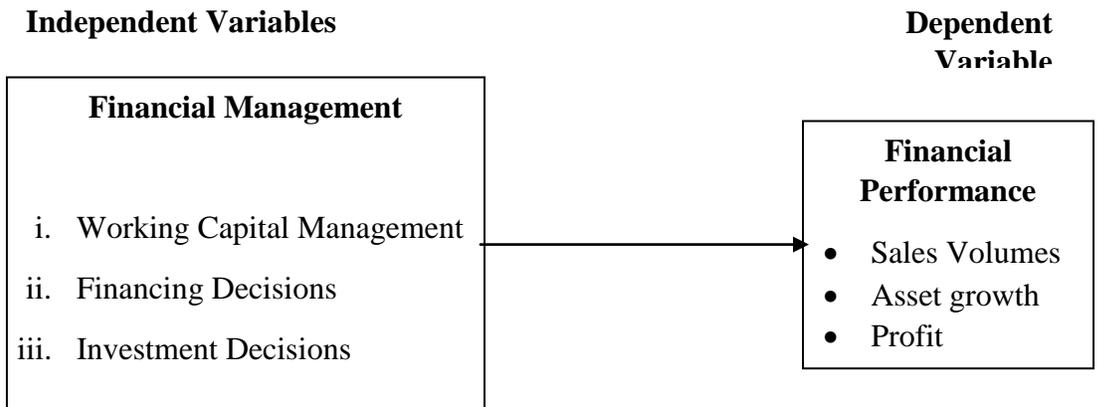


Figure 2.1: Conceptual Model

Source: Researcher, 2017

CHAPTER THREE RESEARCH DESIGN AND METHODOLOGY

3.0 Introduction

This chapter presents the methods and procedures that was used to carry out this study. Specifically, the chapter spells out the research design, the population studied, the sampling strategy, the data collection process and how data will be analyzed and findings presented.

3.1 Research Methodology

3.2 Research Design

This research was a descriptive study using descriptive research design method. This method is similar to the method used by Burbank (2005) who conducted a survey to investigate the client poverty and participation in Kenyan NGOs' small enterprise programs. Just like in this research Burbank's research also focused on SMEs. A descriptive research design describes or defines a subject, through creating a profile of a group of problems, people, or events, through the collection of data, the tabulation of the frequencies on research variables and the analysis of their interaction, (Cooper and Schindler, 2006).

This research approach was appropriate for this study based on the fact that the researcher intended to collect detailed and current information that would enable identifying and describing the current situation concerning financial management in SME'S in Kiambu Town. The survey enabled a comparative analysis of the variation of financial management from one small enterprise to another.

3.3 Location of the Study

The research was done on SMEs located in Kiambu town in Kiambu County. Kiambu town is the commercial and administrative capital of Kiambu County. The town is 16 kilometers North East of Nairobi City with coordinates 1° 10' 0" S, 36° 50' 0" E. The town is almost considered a suburb of Nairobi with most middle class residing here while daily commuting to Nairobi for work. The town is witnessing rapid growth with major road infrastructure and complex real estate developments taking place around and neighboring environs. Figure 3.1 below shows the map of Kiambu town. The orange line demarcates the town and the location of the SMEs to be studied.

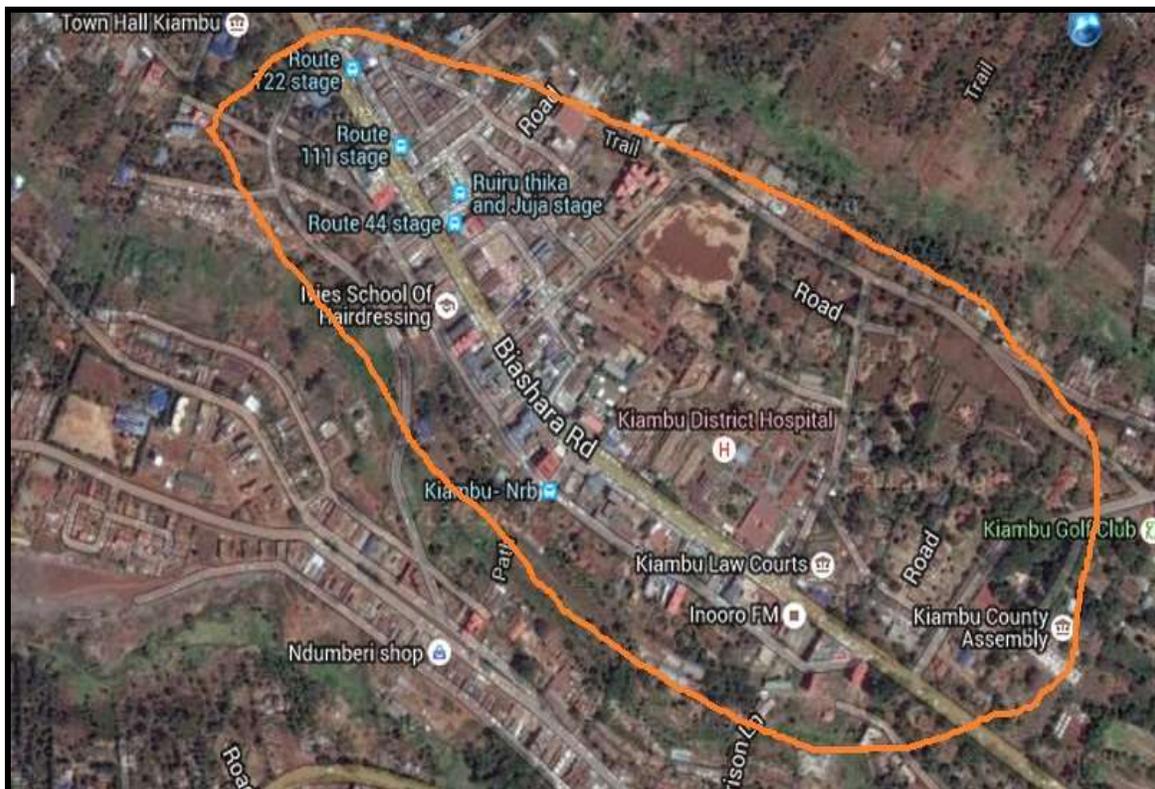


Figure 3.1: Map of Kiambu Town

3.4 Target Population

Target population in statistics is the specific population about which information is desired. According to Ngechu (2004), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. This definition ensures that the population of interest is homogeneous and by population the researcher means the complete census of the sampling frames. Population studies also called census are more representative because everyone has an equal chance to be included in the final sample that is drawn according to Mugenda and Mugenda (2003). The target population of this study comprised of 2,405 registered SMEs operating in Kiambu town, (as per Kiambu town registration, 2015). The unit of analysis for this study is an individual organization.

3.5 Samples Technique and Sample Size

According to The Central Limit Theorem any random sample size greater than 30 is approximately normally distributed irrespective of the population size and can be an accurate representative of the population. The theorem, therefore, allows a researcher to select any sample greater than 30. The study used a sample of 100 SMEs located within Kiambu town selected by simple random sampling. The manager or owners of each SME responded to the questionnaire.

3.6 Research Instrument

A self-administered questionnaire was used to collect data from the owners or managers of the identified SMEs in Kiambu town. The questionnaire used mainly the closed ended questions with few open ended questions. The questionnaire was divided into five sections. Section A captures the demographic information about the respondent. Section B captures information concerning working capital management. Section C focuses on investment decisions while Section D focuses on financing decisions. Section E captures information on financial performance.

3.7 Validity of the Research Instrument

Validity is the extent to which an instrument measures what it purports to measure (Saunders, 2007). Content validity is the key type of validity for this study. Content validity focuses on the degree to which the instrument fully assesses or measures the construct of interest. The validity of the questionnaire was ascertained by seeking expert opinion from scholars in the department of finance at Pan Africa University.

3.8 Reliability of the Research Instrument

Reliability refers to the extent to which a questionnaire, test, observation or any measurement procedure produces the same results on repeated trials (Barnett, 2000). It is the stability or consistency of scores over time or across raters. To establish reliability, the test-retest approach was used. Owners of 10 SMEs were randomly selected to respond to the questionnaire in a pilot data collection program. The owners responded to the questionnaire on two occasions without their expectation. The responses from the first occasion were compared to those of the second occasion using Pearson's correlation coefficient. The owners who took part in the piloting did not participate in the main data collection activity.

3.9 Data collection

Data from identified SMEs was collected by means of the self-administered questionnaire. The researcher delivered the questionnaire in person to the respondents and provided guidelines on the way to complete the questionnaire and picked the questionnaire after they had been filled on the spot. The questionnaires were completed by way of filling in blank spaces or ticking from a set of options in a five point Likert scale.

3.10 Data Analysis

Collected data was first coded, sorted and organized for analysis. Summary statistics like the frequencies, percentages and means were used to analyze the data. Graphical presentations in form of pie charts, bar graphs, and tables were used to describe the nature of the distribution of the data obtained from respondents. To analyze the relationship between working capital management, investment decisions, financing decisions and financial performance a regression analysis and analysis of variance was conducted. The regression method was used since there are data collected by use of the Likert Scales concerning the dependent variable and independent variables in this research. The regression model took the following form.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where

- Y = Financial Performance
- β_0 = Intercept term
- X_1 = Working Capital Management
- X_2 = Investment Decisions
- X_3 = Financing Decisions
- β_i = Sensitivity of Financial Performance to the independent variable i
- ε = Error term

To test the statistical significance of each of the regression variables β_0 and the β_i the T-tests at 95 % confidence level was used. The F-Test at 95 % was used to test the statistical significance of the whole regression. The F-test was used to test the significance of the effect of each variable on financial performance. The coefficient of determination R^2 and the adjusted R^2 was used to determine the strength at which the variation in the independent variables explains the variation in the dependent variable.

3.11 Logistical and Ethical Considerations

The capture of information required was done using legally accepted ways. No respondent was coerced into giving out information either by force or by reward. The researcher first sort the permission to conduct the research from Pan Africa University and the targeted SME. The respondents were assured of confidentiality and anonymity and that the information obtained was used specifically for research purposes and was not used in any manner detrimental to the well-being of the respondents.

CHAPTER FOUR FINDINGS AND DISCUSSIONS

4.0 Introduction

This chapter contains a presentation of the study findings. It is aligned according to the research objectives. The first part of the chapter presents findings on the reliability of the study instrument constructs. The second part presents the demographic characteristics of the respondents. This is followed by the findings on the relationship between financial performance and the independent variables [working capital management; Investment decisions; and financial decisions].

4.1 Reliability Tests

A construct composite reliability co-efficient (Cronbach alpha) was used to determine reliability. The aim of this test was to determine whether the instruments consistently measured what they were intended to measure. A Cronbach alpha of 0.6 and above, for all the constructs, was considered to be adequate for this study.

Table 4.1 indicates that Cronbach's alpha for working capital management scale was 0.760, which registered acceptability. Table 4.1 also shows that the item-total correlation ranges from 0.018 to 0.630 and that removal of questions WC2, WC3 and WC10 resulted in higher Cronbach's alpha, thus the questions were eliminated from the scale as they lowered the reliability of the constructs.

Table 4.1: Cronbach's Alpha Analysis for Working Capital Management Scale

Working Capital Management Scale	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted	Cronbach's Alpha
The business has bank account [WC1]	.301	.753	
The business normally experiences cash shortage [WC2]	.217	.761*	
The business sells goods or services by cash [WC3]	.018	.779*	
Cash budget is helpful in decision making [WC4]	.480	.735	
The business sets minimum cash balance [WC5]	.314	.752	
Temporarily cash surplus is invested in marketable securities [WC6]	.512	.731	
The business has internal control on cash [WC7]	.630	.718	.760
There is separation of cashier duties from accounting duties [WC8]	.586	.718	
The owner /manager is trained on working capital management [WC9]	.302	.754	
Most sales are credit sales [WC10]	.177	.766*	
The business has a set credit policy in place [WC11]	.454	.737	
The business applies the set credit policy while extending credit [WC12]	.441	.738	
The sales are reconciled with inventory change [WC13]	.574	.730	

Table 4.2 indicates that Cronbach's alpha for investment decisions scale was 0.825, which registered acceptability. Table 4.2 also shows that the item-total correlation ranges from 0.051 to 0.889 and that removal of questions ID4 and ID6 resulted in higher Cronbach's alpha, thus the questions were eliminated from the scale as they lowered the reliability of the construct.

Table 4.2: Cronbach's Alpha Analysis for Investment Decisions Scale

Investment Decisions Scale	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted	Cronbach's Alpha
The business has cash for investment in long term projects [ID1]	.570	.803	
The business invests in non-current assets [ID2]	.889	.758	
The business utilizes fully the non-current assets [ID3]	.822	.770	
The business uses Net Present Value (NPV) to assess the investment [ID4]	.051	.844*	
The business uses Payback Back Period to assess the investment [ID5]	.450	.816	.825
The business invests without evaluating the investment [ID6]	.287	.831*	
The business invests in real estate [ID7]	.506	.811	
The business invests in shares on the stock exchange [ID8]	.440	.816	
The business reviews investment projects after a certain period [ID9]	.595	.801	
The owner /manager has been trained on investment decision Making [ID10]	.417	.818	

Table 4.3 indicates that Cronbach's alpha was 0.606, which registered acceptability of the scale. Use of questions FD1 and FD6 resulted in negative alpha. Thus the questions were eliminated from the scale and the reliability test recalculated. Table 4.3 also shows that the item-total correlation ranges from 0.182 to 0.669.

Table 4.3: Cronbach's Alpha Analysis for Financial Decisions Scale

Financial Decisions Scale	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted	Cronbach's Alpha
The business has easy access to bank loans	.669	.241	
The business uses internally generated cash sources and borrowed funds	.481	.464	0.606
The business uses borrowed funds only	.287	.601	
The business sets the capital structure based on the theory	.182	.605	

Table 4.4 indicates that Cronbach's alpha was 0.740, which registered acceptability of the scale. Table 4.4 also shows that the item-total correlation ranges from 0.328 to 0.695 and that deletion of question FP1 increases the Cronbach's alpha. Therefore, the questions were removed from the scale as it reduced the reliability of the scale.

Table 4.4: Cronbach’s Alpha Analysis for Financial Performance Scale

Financial Performance Scale	Corrected Item-Total Correlation	Cronbach's Alpha if Item Deleted	Cronbach’s Alpha
Rewards for your employees keep getting better [FP1]	.328	.762*	
The sales of your business have always grown [FP2]	.695	.626	
The value of assets has been growing [FP3]	.613	.649	.740
Profits have been growing [FP4]	.531	.683	
Operational costs have been reducing [FP5]	.406	.729	

4.2 Demographic Characteristics

4.2.1 Response Rate

The sample size for the study was 100 SMEs located within Kiambu town. Figure 4.1 indicates 78% response rate.

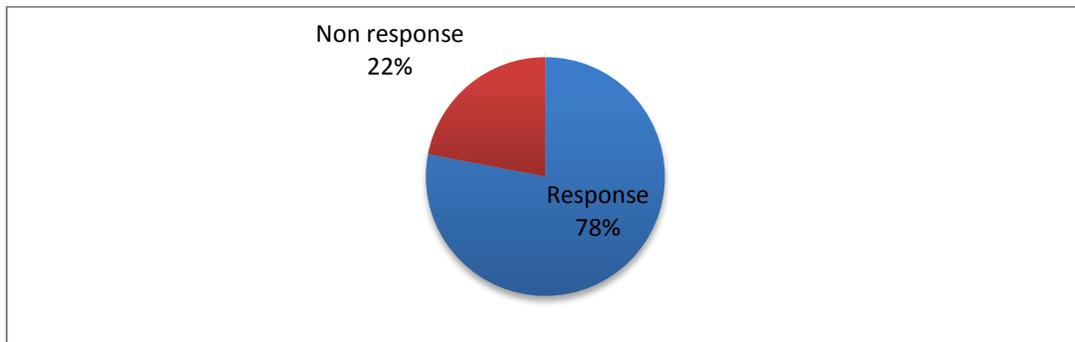


Figure 4.1: Response Rate

4.2.2 Number of Employees

The study recorded 12 as the least number of employees and 98 as the highest number employed by the SMEs studied. Figure 4.2 illustrates that majority of the businesses at 59% employed between 11 and 20; 23% employed above 51; 10% employed between 31 and 40; 5% employed between 21 and 30; while 3% employed between 41 and 50 employees.

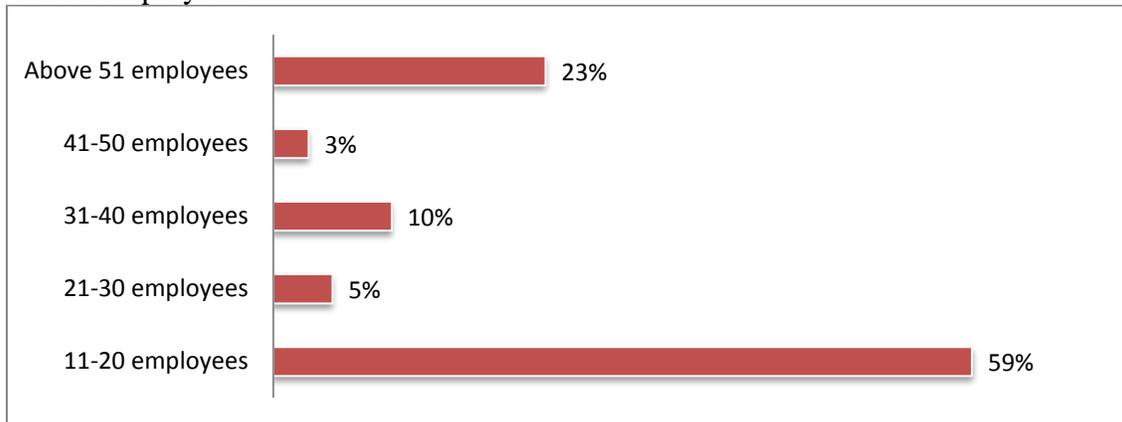


Figure 4.2: Number of Employees

4.2.3 Years in Operation

Figure 4.3 illustrates that majority of the businesses at 47% had been in operation for 2 to 4 years; 39% for 6 to 10 years; and 14% for more than 10 years.

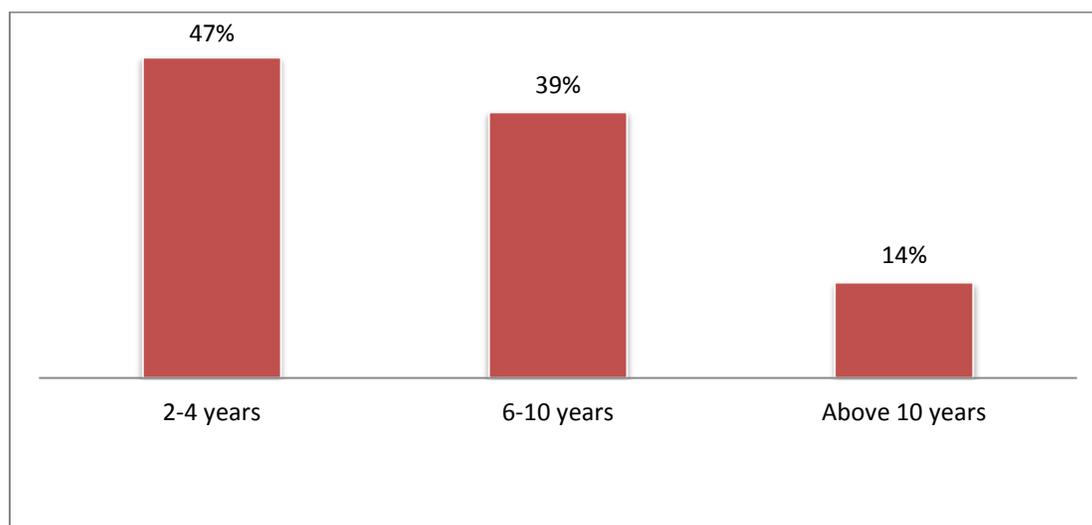


Figure 4.3: Years in Operation

4.2.4 Business Category

Table 4.5 indicates that 21 business categories were represented in the study with small restaurants with bars being the majority with 14% representation followed by Small transporting companies at 10%. The rest had between 1% and 9% representation.

Table 4.5: Business Category

Business Category	Percentage [%]
1. Medium Trader Shop or Retail Services	7.7
2. Small Trader, Shop or Retail Services	6.4
3. Small Transporting Company	10.3
4. Small Petrol Station	5.1
5. Small Storage Company	3.8
6. Small Communication Company	1.3
7. Small Agricultural Producer/Processor/Dealer	1.3
8. Medium Lodging House with Restaurant/Bar	1.3
9. Small Lodging House	2.6
10. Small Lodging House Basic Standard	5.1
11. Small Restaurant with Bar	14.1
12. Large Eating House; Snacks; Tea House	1.3
13. Medium Professional Service Firm	1.3
14. Small Professional Services Firm	2.6
15. Medium Financial Services	2.6
16. Small Financial Services	7.7
17. Small Private Health Facility	7.7
18. Doctor/Dentist/Physiotherapist	1.3
19. Small Industrial Plant	9.0
20. Medium Workshop, Services/ Repair Contractor	5.1
21. Small Workshop Services Repair Contractor	2.6
Total	100.0

4.2.5 Annual Turnover

Figure 4.4 indicates that majority at 43% estimated their annual turnover to lie between Ksh. 500,001 and Ksh. 1,000,000; followed 25% between Ksh. 1,000,001 and Ksh. 3,000,000; 25% between Ksh. 3,000,001 and Ksh. 4,999,999; and 7% less than Ksh. 500,000.

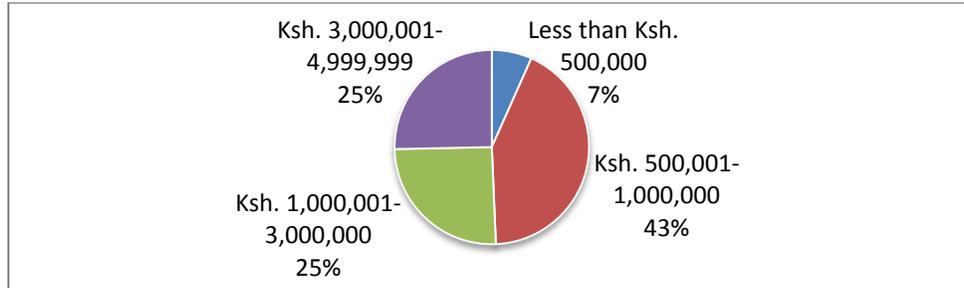


Figure 4.4: Annual Turnover

4.2.6 Average Percentage Profit

Figure 4.5 indicates that majority of the businesses at 39% earned a profit [net profit as percentage of assets] of between 21% and 30%; 29% of the businesses earned between 31% and 40%; 27% of the businesses earned between 11% and 20%; while only 5% of the businesses earned a profit less than 10%.

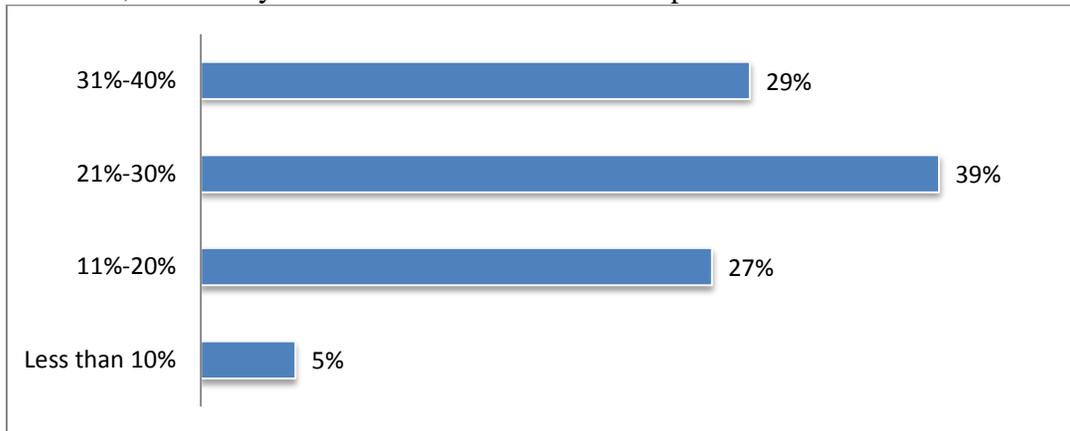


Figure 4.5: Average Profits

4.2.7 Type of Business Ownership

Figure 4.6 indicates that majority [46%] of the businesses were registered as sole proprietorship; 28% as limited companies; 25% as partnership; 1% were cooperatives.

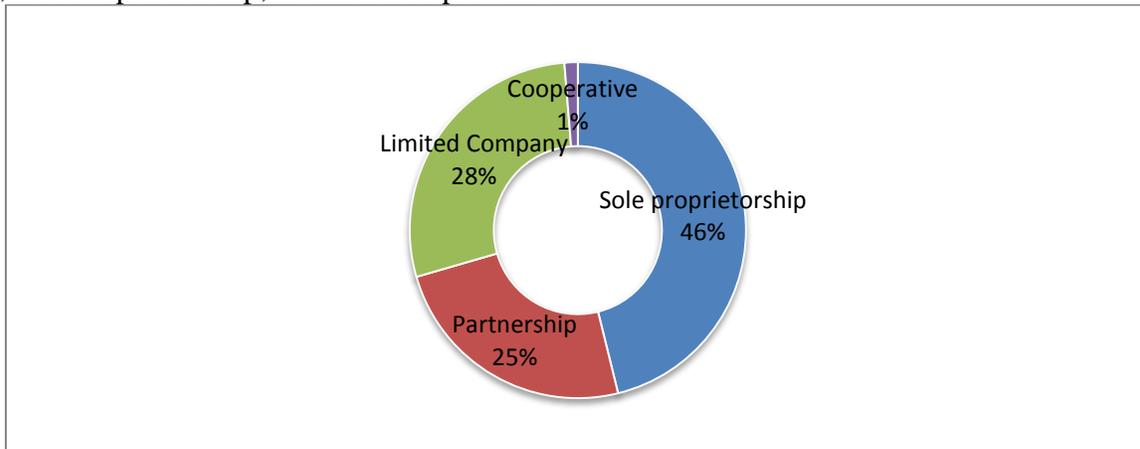


Figure 4.6: Type of Business Ownership

4.2.8 Management Structure

Figure 4.7 indicates that majority of business owners [55%] hired managers to manage their businesses while 45% of the businesses were owner managed.

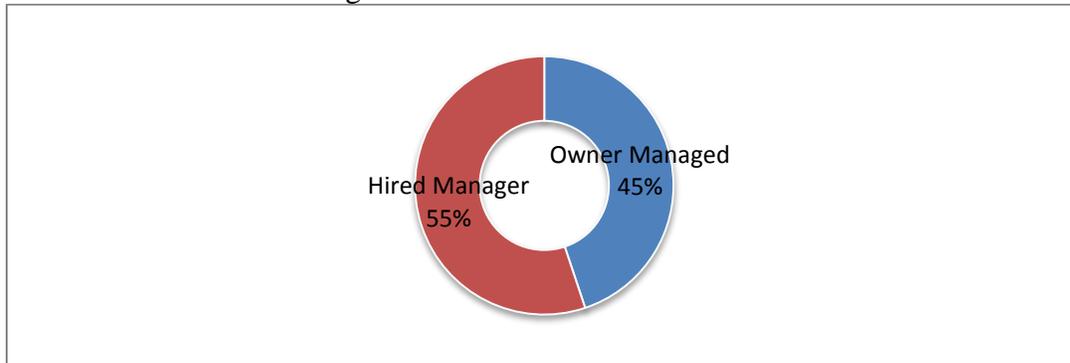


Figure 4.7: Management Structure

4.2.9 Debt Financing

Majority at Forty six percent indicated that they run their businesses entirely on internal funds [i.e. no debt financing]; 20% had between 21% and 50% level of debt financing; 12% had between 11% and 20% level of debt financing; 11% had between 1 and 10% debt financing; 8% had over 70% debt financing while 3% had between 51% and 70% debt financing as indicated in Figure 4.8.

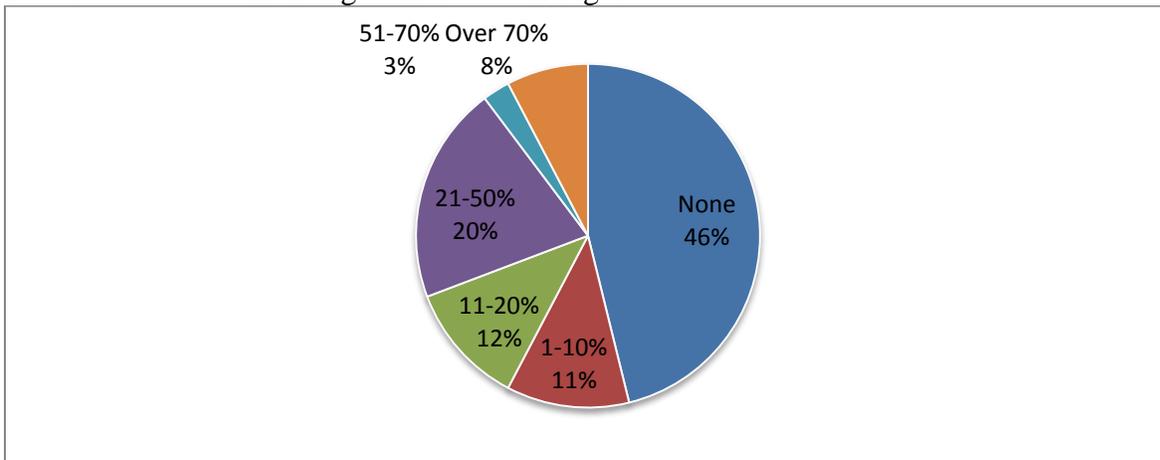


Figure 4.8: Debt Financing

4.3 Working Capital Management and Financial Performance

The summated scale in Table 4.6 indicates that majority agreed that the SMEs have working capital management systems in place [23% to moderate extent; 22% to great extent and 17% to very great extent]. The table further indicates that majority of the SMEs own bank accounts [8% to moderate extent; 10% to great extent and 73% to very great extent]; use cash budgets to make decisions [28% to moderate extent; 40% to great extent and 6% to very great extent]; set minimum cash balance [39% to moderate extent; 13% to great extent and 5% to very great extent]; have internal control on cash [32% to moderate extent; 35% to great extent and 18% to very great extent]; separates cash duties from other duties [9% to moderate extent; 25% to great extent and 35% to very great extent]; have their management trained on working capital management [22% to moderate extent; 28% to great extent and 10% to very great extent]; and the sales are reconciled with inventory [35% to moderate extent; 40% to great extent and 9% to very great extent].

On the contrary, Table 4.6 indicates that majority disagreed that the SMEs have a credit policy in place [39% not at all; 24% to little extent]. This is corroborated by the finding that majority disagreed that the SMEs apply set credit policy while extending credit [37% Not at all; 27% too little extent]. This implies that there is a preference towards cash based transactions among the SMEs.

Table 4.6: Working Capital Management Scale

Variable	Percentage [%]					Mean	SD
	NA (1)	LE (2)	ME (3)	GE (4)	VGE (5)		
Business has bank account	3	6	8	10	73	4.45	1.052
Cash budget is helpful in decision making	13	13	28	40	6	3.14	1.136
Business sets minimum cash balance	15	28	39	13	5	2.67	1.057
Temporally cash surplus is invested in marketable securities	47	23	21	5	3	1.95	1.115
Business has internal control on cash	8	8	32	35	18	3.47	1.113
There is separation of cashier duties from accounting duties	12	18	9	25	35	3.54	1.437
The owner /manager is trained on working capital management	8	32	22	28	10	3.01	1.157
The business has a set credit policy in place	39	24	21	12	5	2.21	1.221
The business applies the set credit policy while extending credit	37	27	14	15	6	2.27	1.286
The sales are reconciled with inventory change	0	17	35	40	9	3.41	0.874
Summated Scale	18	20	23	22	17	3.012	

The study then sought to determine if there was statistically significant relationship between working capital management and financial performance. To achieve this, regression analysis was done. R^2 of 0.005 in Table 4.7 shows a weak positive relationship between working capital management and financial performance [$R=0.07$; $R^2=0.005$; adjusted $R^2=0.009$]. The finding indicates that considered individually, working capital management contributes to only 0.5% variance in financial performance. This would be expected because there are numerous factors that impact on financial performance of SMEs and many of which will be important predictors of financial performance than any simple association with working capital management alone. The low R^2 [0.05] indicates that a model containing only working capital management is likely to be a poor predictor of the financial performance for any particular SME.

Table 4.7: Model Summary for Working Capital Management and Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.070 ^a	.005	.009	.846

a. Predictors: (Constant), Working Capital Management

Analysis of Variance [ANOVA] findings in Table 4.8 confirms a statistically significant but weak positive relationship between working capital and financial performance, [$F(1, 71) = 3.48, p < .05$].

Table 4.8: ANOVA for Working Capital Management and Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.249	1	.249	3.480	.005
	Residual	50.792	71	.715		
	Total	51.041	72			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Working Capital Management

Table 4.9 shows that, if all the other factors are zero, the influence of working capital management will lead to a 4.015 increase in financial performance. Further, a unit increase in working capital management will lead to a 0.081 increase in financial performance.

Table 4.9: Multiple Regression Analysis for Working Capital Management

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	4.015	.432		9.298	.000
	Working Capital Management	.081	.138	-.070	-.590	.005

4.4 Investment Decisions and Financial Performance

The summated scale in Table 4.10 indicates that majority disagreed that the SMEs take an aggressive investment decisions [33% not at all; 24% little extent and 20% moderate]. The table further indicates that majority disagreed that the SMEs have cash for investment in long term projects [21% not at all; 29% little extent and 27% moderate]; invests in non-current assets [49% not at all; 10% little extent and 10% moderate]; utilizes fully the non-current assets [39% not at all; 18% little extent and 19% moderate]; uses Payback Period to assess the investment [43% not at all; 33% little extent and 21% moderate]; invests in real estate [50% not at all; 13% little extent and 15% moderate]; management has been trained on investment decision making [15% not at all; 44% little extent and 26% moderate]; invests in shares on the stock exchange [39% not at all; 39% little extent and 15% moderate].

On the contrary majority agreed that the SMEs review investment projects after a certain period [24% moderate; 44% great extent and 9% very great extent].

Table 4.10: Investment Decisions Scale

Variable	Percentage [%]					Median	SD
	NA (1)	LE (2)	ME (3)	GE (4)	VGE (5)		
The business has cash for investment in long term projects	21	29	27	15	9	2.64	1.227
The business invests in non-current assets	49	10	10	17	14	2.37	1.555
The business utilizes fully the non-current assets	39	18	19	10	14	2.44	1.447
The business uses Payback Back Period to assess the investment	43	33	21	4	0	1.86	0.884
The business invests in real estate	50	13	15	14	7	2.17	1.381
The business invests in shares on the stock exchange	39	39	15	4	4	1.96	1.025
The business reviews investment projects after a certain period	10	13	24	44	9	3.28	1.127
The owner /manager has been trained on investment decision Making	15	44	26	12	4	2.45	1.015
Summated Scale	33	24	20	15	8	2.40	

R^2 of 0.002 in Table 4.11 shows a weak positive relationship between investment decisions and financial performance [$R=0.040$; $R^2=0.002$; adjusted $R^2=0.012$]. The finding indicates that considered individually, investment decisions contributes to only 0.2% variance in financial performance. This is just as we would expect because there are numerous factors that impact on financial performance of SMEs and many of which will be important predictors of financial performance than any simple association with investment decisions alone. The low R^2 [0.02] indicates that a model containing only investment decision is likely to be a poor predictor of the financial performance for any particular SME.

Table 4.11: Model Summary for Investment Decisions and Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.040 ^a	.002	.012	.842

a. Predictors: (Constant), Investment decisions

Analysis of Variance [ANOVA] findings in Table 4.12 indicates statistically significant relationship between investment decisions and financial performance, [$F(1, 75) = 12.0, p < .05$].

Table 4.12: ANOVA for Investment Decisions and Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.085	1	.085	12.0	.007 ^b
	Residual	53.162	75	.709		
	Total	53.247	76			

a. Dependent Variable: Financial Performance
b. Predictors: (Constant), Investment Decisions

Table 4.13 shows that, if all the other factors are zero, the influence of investment decisions will lead to a 3.865 increase in financial performance. Further, a unit increase in investment decision will lead to a 0.036 increase in financial performance.

Table 4.13: Multiple Regression Analysis for Investment Decisions

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.865	.265		14.582	.000
	Investment Decisions	.036	.103	.040	.347	.007

4.5 Financing Decisions and Financial Performance

The summated scale in Table 4.14 indicates that majority disagreed that the SMEs take an aggressive financial decisions [40% not at all; 19% little extent and 16% moderate]. The table further indicates that majority disagreed that the SMEs uses borrowed funds only [81% not at all; 10% little extent and 5% moderate]; and that business sets the capital structure based on the theory [68% not at all; 22% little extent and 6% moderate].

On the contrary, majority agreed that the SMEs use internally generated cash sources and borrowed funds [41% moderate; 26% great extent and 8% very great extent]; and that business has easy access to bank loans [13% moderate; 33% great extent and 26% very great extent].

Table 4.14: Financial Decisions Scale

Variable	Percentage [%]					Mean	SD
	NA (1)	LE (2)	ME (3)	GE (4)	VGE (5)		
The business has easy access to bank loans	8	21	13	33	26	3.48	1.294
The business uses internally generated cash sources and borrowed funds	3	23	41	26	8	3.13	0.945
The business uses borrowed funds only	81	10	5	4	0	1.32	0.747
The business sets the capital structure based on the theory	68	22	6	1	3	1.49	0.879
Summated Scale	40	19	16	16	9	2.335	

R^2 of 0.160 in Table 4.15 shows a moderate positive relationship between financial decisions and financial performance [$R=0.400$; $R^2=0.160$; adjusted $R^2=0.149$]. The finding indicates that considered individually, financial decisions contributes to 16.0% variance in financial performance. This means that the other 84% variance in financial performance is attributed to other factors other than financial decisions.

Table 4.15: Model Summary for Financial Decisions and Financial Performance

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate
1	.400 ^a	.160	.149		.776

a. Predictors: (Constant), Financial Decision

Analysis of Variance [ANOVA] results in Table 4.16 indicates that there is a positive statistically significant relationship between financial decisions and financial performance [$F(1, 75) = 14.282, p < .05$].

Table 4.16: ANOVA for Financial Decisions and Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.605	1	8.605	14.282	.000 ^b
	Residual	45.187	75	.602		
	Total	53.792	76			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Financial Decisions

Table 4.17 shows that, if all the other factors are zero, the influence of financial decisions will lead to a 2.674 increase in financial performance. Further, a unit increase in financial decisions will lead to a 0.480 increase in financial performance.

Table 4.17: Multiple Regression Analysis for Financial Decisions

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.674	.302		8.849	.000
	Financial Decision	.480	.127	.400	3.779	.000

4.6 Combined Effect of Financial Management Practices on Financial Performance

R^2 of 0.183 in Table 4.18 shows a moderate positive relationship between financial management practices and financial performance [$R=0.428$; $R^2=0.183$; adjusted $R^2= -0.146$]. The finding indicates that considered collectively, financial management practices contributes to 18.3% variance in financial performance. The other 81.7 % variance in financial performance would be attributed to others factors beyond the scope of the current study.

Table 4.18: Model Summary for Combined Financial Management Practices and Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.428 ^a	.183	.146	.784

a. Predictors: (Constant), Financial decisions; Working Capital Management; Investment decisions

Analysis of Variance [ANOVA] results in Table 4.19 indicates a statistically positive relationship between financial management practices and financial performance [$F(3, 67) = 5.004, p < .05$].

Table 4.19: ANOVA for Financial Management Practices and Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	9.224	3	3.075	5.004	.003 ^b
	Residual	41.171	67	.614		
	Total	50.394	70			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Financial decisions; Working Capital Management; Investment decisions

Table 4.20 shows that, if all the other factors are zero, the influence of financial management practices will lead to a 3.222 increase in financial performance. Further, a unit increase in working capital management will lead to a 0.140 increase in financial performance; a unit increase in investment decisions will lead to a 0.085 increase in financial performance; and a unit increase in financial decision will lead to a 0.519 increase in financial performance.

Table 4.20: Multiple Regression Analysis for Working Capital Management

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.222	.453		7.117	.000
	Working Capital	.140	.157	-.121	-.894	.003
	Investment decisions	.085	.120	-.096	-.704	.004
	Financial decisions	.519	.136	.441	3.820	.000

For modeling the relationship between financial management practices and financial performance, the following multiple regression equation is applied;

$$\gamma = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \varepsilon$$

Where γ = Financial Performance [Dependent variable]

α = Constant

x_1 = Working Capital Management [Independent variable 1]

x_2 = Investment Decisions [Independent variable 2]

x_3 = Financial Decisions [Independent variable 3]

ε = Standard error

β_1 = Coefficient of Working Capital Management.

β_2 = Coefficient of Investment Decisions.

β_3 = Coefficient of Financial Decisions.

Hence;

$$\gamma = 3.222 + 0.140 x_1 + 0.084 x_2 + 0.519 x_3$$

The combined multiple regression model indicates that, keeping all factors constant, out of the three variables of financial management practices analyzed, financial decision has the most positive significant influence on financial performance [a unit increase in financial decision will lead to a 0.519 increase in financial performance]. This was followed by working capital decisions [a unit increase in working capital decision will lead to a 0.140 increase in financial performance] and investment decisions [a unit increase in investment decision will lead to a 0.084 increase in financial performance].

4.7 Discussions

4.7.1 Relationship between Working Capital Management and Financial Performance

The study showed that considered individually, there is a weak positive relationship between working capital management and financial performance. Good working capital management was demonstrated by the fact that majority of the SMEs studied had bank accounts; use cash budgets to make decisions; have internal control on cash; separates cash duties from other duties; have their management trained on working capital management; and the sales are reconciled with inventory.

The findings that working capital management has a positive relationship with performance is in line with a study by Charitou et al., (2010) which indicated that working capital management leads to improved profitability. Furthermore finding that the SMEs have working capital management systems in place further supports findings by Kirui (2013) who indicated weak financial performance where working capital management is poor.

The finding that the SMEs studied use cash budgets to make decisions; have internal control on cash; separates cash duties from other duties; and have their management trained on working capital management shows that the SMEs have policies on financial matters. This supports findings by Mwangi et al. (2014) who indicated that an aggressive financing policy had a significant positive effect on return on assets and return on equity while investing in the stock market.

The study supports the general financial performance theoretical assumption that when assessing the financial performance of any firm working capital forms one of the most critical elements that contributes to financial performance.

4.7.2 Relationship between Investment Decision and Financial Performance

The study showed that considered individually, there is a weak positive relationship between investment decision and financial performance. The study showed that majority disagreed that the SMEs take aggressive investment decisions. They disagreed that the SMEs have cash for investment in long term projects; that they invest in non-current assets; that they utilise fully the non-current assets; that they use Payback Period to assess the investment; that they invest in real estate; that they have their management trained on investment decision making; and that they invest in shares on the stock exchange.

The finding indicates a challenge with access to equity and credit facilities for the SMEs to aggressively invest. This is in line with Kamunge et al. (2014) who indicated that access to finance and financial management experience are the key factors affecting the performance of the businesses. This shows that aggressive investment decisions are slowed down by the fact that the SMEs lack cash for investment in long term projects; lack resources to invest in non-current assets; lack capacity to utilize fully the non-current assets; lack financial capacity to invest in real estate and stock market. They even lack financial capacity to effectively train their management on investment decision making.

Despite lack of resources for aggressive financial decisions, the study also showed that there is a positive relationship between investment decisions and financial performance. This is in line with an earlier study by Heshmati and Loof (2008) which indicated that there is a two way causal relationship between investment decision and financial performance. This meant investment decisions determined financial performance while financial performance, too, determined investment decision.

The study is in line with the theoretical assumptions that the right investment decisions which encompasses the decision as to what to invest in, where to invest, when to invest and how much to invest is linked to financial performance of the SMEs.

4.7.3 Relationship between Financial Decision and Financial Performance

The study showed that considered individually, there is a moderate positive relationship between financial decisions and financial performance. This supports findings by Chepkemoi (2013) who while analyzing the effect of capital structure as part of financial decision on the financial performance of SME in Nakuru Town of Nakuru County indicated that capital structure as part of financial decision positively affects firm performance by positively affecting liquidity and sales growth.

The study also showed that majority disagreed that the SMEs take aggressive financial decisions. The lack of aggressive financial decision is also linked to inadequate financial capabilities. The study also showed that majority disagreed that the SMEs use borrowed funds only; and that business sets the capital structure based on the theory. This indicates that the SMEs prefer a combination of both debt and equity for investment and further the SMEs prefer innovative measures of financial decision making rather than sticking to theory. This supports findings by Karanja (2014) who conducted a study to establish the effect of capital structure on financial performance of SMEs in dairy sector in Kiambu County. The study revealed that debt equity ratio was a significant cause of financial performance. Similarly, debt equity ratio and liquidity ratios also had significant effect on financial performance.

The study supports the general assumption that financial performance of a firm is linked to its financial decisions [capital structure decisions]. The argument is that a firm needs to obtain the best financing mix, that is, the mix where the market value of the firm is maximized. Based on the market cost of debt or equity financing, the firm needs to establish the best combination of debt and equity so as to raise the appropriate amounts through the best available sources. The study supports the Pecking Order Theory as majority of the SMEs used internal funds to finance their business.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This is a presentation of the study summary, discussions, conclusions and recommendations in line with the research questions raised in chapter one.

5.1 Summary of findings

The purpose of the study was to establish the effect of financial management practices on financial performance of small and medium enterprises in Kiambu town in Kenya. The study had three research questions. What is the effect of working capital management on the financial performance of Small and Medium Enterprises in Kiambu town? What is the contribution of investment decisions towards the financial performance of Small and Medium Enterprises in Kiambu town? How does financing decisions affect the financial performance of Small and Medium Enterprises in Kiambu town?

The study was descriptive in nature. The scope of the study was limited to SMEs located in Kiambu town in Kiambu County. The target population of this study comprised of 2,405 registered SMEs operating in Kiambu town. The unit of analysis for this study was individual organizations. The study used random sampling method to sample 100 SMEs located within the study area. A structured questionnaire was used to collect data from the owners or managers of the identified SMEs. Data analysis involved descriptive statistics [frequencies, percentages and means] and inferential statistics [regression analysis and analysis of variance]. The findings were presented in tables and figures.

First, the study showed a weak but a positive relationship between working capital management and financial performance. This means that financial performance can be predicted by working capital management system adopted by the SME. Zero point five percent variance in financial performance was attributed to capital management alone. That is, an effective working capital management leads to an enhanced financial performance of the SME. Secondly, the study showed a weak positive relationship between investment decisions and financial performance. This means that financial performance can be predicted by investment decisions adopted the SME. Zero point two percent of variance on financial performance was attributed to investment decisions alone. That is, an effective investment decision leads to enhanced financial performance of the SME.

Thirdly, the study showed a moderate positive relationship between financial decisions and financial performance. The study indicated that considered individually, financial decisions contributed 16% variance in financial performance. This means that financial performance can be predicted by financial decisions adopted the SME. That is, an effective financial decision leads to enhanced financial performance of the SME. Finally, the study showed that the combined effect of financial management practices [working capital management,

investment decision, financial decision] have a moderate positive relationship between financial management practices and financial performance. The study indicated that considered collectively, financial management practices contributes to 18.3% variance in financial performance. The other 81.7 % variance in financial performance would be attributed to other factors beyond the scope of the study.

5.2 Conclusions

5.2.1 Relationship between Working Capital Management and Financial Performance

The study showed that good working capital practices such as effective management of cash conversion cycle and all its major components such as days in inventory, day's sales outstanding and creditors payment period are closely linked to the firms' financial performance. That is, an effective working capital management leads to an enhanced financial performance of the SME.

5.2.2 Relationship between Investment Decision and Financial Performance

This study showed that the investment decisions which inform the firm's asset portfolio used to generate the cash flows determines the firms' profitability, value, viability and overall financial performance. Hence, when a firm makes the right financial decisions, the prospects of enhanced financial performance is improved. That is, an effective investment decision leads to enhanced financial performance of the SME.

5.2.3 Relationship between Financial Decision and Financial Performance

The study showed that majority agreed that the SMEs use internally generated cash sources and borrowed funds through bank loans. This means that the owners of these organizations have established the need to balance when, where, how much and how to acquire funds to meet their investment needs. They balance equity and debt proportions to maximize the value of the firm. That is, an effective investment decision leads to enhanced financial performance of the SME.

5.2.4 Relationship between Financial Management Practices and Financial Performance

The study showed that financial management practices contributes to 18.3% variance in financial performance. Financial decision has the most positive significant influence on financial performance [a unit increase in financial decision will lead to a 0.519 increase in financial performance]. This was followed by working capital decisions [a unit increase in working capital decision will lead to a 0.140 increase in financial performance] and investment decisions [a unit increase in investment decision will lead to a 0.084 increase in financial performance].

5.3 Recommendations

5.3.1 Recommendations for Improvement

5.3.1.1 Working Capital Management

The study has shown a positive relationship between working capital management and financial performance. Further, it has shown that the SMEs have working capital management systems in place yet they do not have credit policies in place. This is a gap. Therefore to further enhance performance the credit policies should be crafted in these organizations to guide credit sales and enhance performance as credit improves on sales turnover. The policies will also be instrumental in guiding how much credit should be advanced at any given time without jeopardizing the cash flow.

5.3.1.2 Investment Decision

The finding indicates a challenge with access to equity and credit facilities for the SMEs to aggressively invest. Thus aggressive investment decisions are slowed down by the fact that the SMEs lack cash for investment in long term projects; lack resources to invest in non-current assets; lack capacity to utilize fully the non-current assets; lack financial capacity to invest in real estate and stock market. They also lack financial capacity to effectively train their management on investment decision making. To address this, the government should ensure creation of favourable policy and economic environment through legislation that facilitate access to affordable sources of funding for SMEs and attract venture capitalists.

5.3.1.3 Financial Decision

Among the three financial management practices studied, financial decisions appeared to be the most significant predictor of financial performance. Therefore developing appropriate strategies and policies that enhance this output will be critical for the SMEs in enhancing their financial performance.

5.3.2 Recommendations for Further Studies

The scope of the study was only limited to Kiambu County. Considering the fact that Kiambu County closely borders the capital, Nairobi and they can comparatively easily access resources and facilities such as financial service compared to areas far flung from the city, generalizing the findings to other areas such as the Northern frontiers may not be wholly accurate. A study that covers other areas of the country with unique characteristics would be welcome. Further the study was limited to only three variables of financial management practices. Broadening the study scope to cover other variables such as activity analysis would be welcome to offer more empirical evidence on the factors that affect financial performance of the SMEs.

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