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FINANCIAL MANAGEMENT PRACTICES AND FIRM PERFORMANCE AMONG MICRO AND SMALL ENTERPRISES IN BUSIA TOWN, KENYA

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Abstract: **Micro and Small Enterprises refer to those enterprises that employ less than 50 employees. Micro enterprises employ 0-9 employees, while small enterprises employ 10 – 49 employees and they account for 75 per cent of the total employment and 30 per cent of the Kenya's gross domestic product. However, two thirds of micro and small enterprises fail within the first few months of operation. Majority of micro and small enterprises are characterized by low growth rate and transition to medium and large enterprises. Access to expansion capital has been adversely cited as a major cause of the low levels of growth. This study seeks to assess how financial management practices affects performance of micro and small enterprises in Busia Town, Kenya. Specific objectives of the study was: to establish the effects of working capital management, Cash Flow Management, asset management and financial reporting on performance of micro and small enterprises. Descriptive research design was adopted to guide the research. The target population for the study was 712 small scale traders in Busia Town from which a sample of 88 respondents was selected using the simple random sampling technique. Data was collected using a questionnaire designed and administered to the business owner managers by the researcher. The data collected was coded and cleaned before analysis. Analysis of data on the other hand was done using both descriptive and inferential statistics. Descriptive statistics such as mean mode, frequency counts and percentages was used to summarize responses. Relationship between variables as well as statistical inferences was done using a multiple regression analysis. Regression model was used in determining relationship between variables. The study is expected to shed light on how micro and small traders in Busia Town manage their finances and whether and how this enhance or hinder business performance.**

Keywords: **Firm Performance, Financial Management Practices, MSEs.**

I. INTRODUCTION

Micro and Small Enterprises (MSEs) refer to those enterprises that employ less than 50 employees. In Kenya, these organizations account for 75 per cent of the total employment and 30 per cent of the gross domestic product (GDP). These organizations have gained prominence in developing countries especially because of their role in industrialization. Their prominence came into the limelight in the late 1970s and early 1980s due to the economic recession originating from the

UK which led to the closure of big manufacturing firms and a decline of industrial growth in many developing countries. Governments of such countries adopted a new policy approach towards the Small Scale Industries which was seen as providing a viable alternative to the large scale industries which were so dependent on foreign exchange (Ankomah, 2012). Since then small scale industries have continued to grow and the concept has since transformed from small scale industries to small scale enterprises to include businesses undertaking activities in other sectors of the economy.

Today, the economic roles played by micro and small enterprises (MSEs) have been well manifested in many countries including Malaysia, Japan, South Korea, and Zambia. In India for instance, they contribute 8% of the national GDP, comprise 50% of total manufactured exports, 45% of total industrial employment and constitute 95% of all industrial units (Ravi, 2009). In Kenya, they account for 75 per cent of total the employment outside small scale agriculture and pastoralist activities sector, and an estimated 30 per cent of the country's GDP (ROK, 2008). In this regard therefore, promoting MSE development encourages the development of indigenous entrepreneurship, enhance regional economic balance through industrial dispersal and generally promote effective utilization of local resources that are considered critical in engineering economic development (Tolentino, 1996; Oboh, 2004; Odeh, 2005).

MSEs have had some peculiar challenges hindering growth, performance and achievement of their purpose in the economy. The problem of poor performance among MSEs spread across all parts of the world and has attracted a lot of interest to players in the sector. In the UK for instance, the number of small business closures stood at 85 per day during the global economic crisis in early 2009 (ILO, 2009) while in Nigeria, the sub-sector has fallen short of expectations (Osotimehin *et al*., 2012). In Kenya, three out of five enterprises fail within the first few months of operation (KNBS, 2007). These challenges have eroded the gains expected of this sector. Notably, Osotimehin, *et al*., (2012) have reported a high correlation between the vibrancy of MSE sector and the degree of poverty, hunger, unemployment, and economic well-being of the citizens. Studies on the challenges to the survival of MSEs have revealed various reasons behind the high mortality rate and suppressed growth in MSEs. Some of the challenges identified in the MSE sector include: leverage on financial structure, tough competition, inadequate margin, low collection in account receivables, incapacity to go for technological advancements, high employee turnover, credit risks and interest rate risks (Raghvan, 2005). A close examination on these challenges reveals that majority are related to management of finances among MSEs which make it difficult even for lenders to be able to assess risk premiums of MSEs and provide credit for business expansion as they are considered high risk ventures (ILO, 2009; IFIRS, 2012). The situation is complicated by lack of access to experts in the course of running the business (Dae Suh, 2011) which could further exacerbate the MSE mortality. In this regard, it is therefore necessary to establish how the financial management practices by MSEs could their performance. To attain this objective, this study set out to answer the following question; how do financial management practices affect performance of MSEs in Busia Town? Financial management practice was operationalized using four construct of financial management namely: working capital management, cash flow management, financial reporting and asset management.

II. STATEMENT OF THE PROBLEM

Ideally, business enterprises are expected to grow in size by transitioning from one stage to the next; from micro enterprises with less than ten employees to large enterprises employing more than 250 people. Despite the high number of enterprises born, their mortality rate remains very high even in developed countries. Proper financial management also play an essential role in helping SMEs gain access to capital which is essential for business growth (IFIRS, 2012). A good MSE financial management system should ensure the following qualitative characteristics are met: understandability, relevance, materiality, reliability, and substance over form, prudence, completeness, comparability, timeliness and a balance between benefit and cost yet they continue to lack in most MSEs. This study therefore is designed to establish how the financial management practices by MSEs affect their performance, business expansion and growth.

III. RESEARCH OBJECTIVE

The general objective of the study was to assess the influence of financial management practices on firms performance among micro and small enterprises in Busia town, Kenya.

Specific Objectives:

i. To establish the effects of working capital management on performance of MSEs in Busia Town. ii.To determine the effects of Cash Flow Management on performance of MSEs in Busia Town. iii.To assess the effects of asset management practices on performance of MSEs in Busia Town. iv.To determine the effects of financial reporting on performance of MSEs in Busia Town.

Research questions:

i. What are theceffects of capital management practices on performance of MSEs in Busia Town? ii. How does Cash Flow Management affect performance of MSEs in Busia Town? iii. How do asset management practices affect the performance of MSEs in Busia Town? iv. How does financial reporting practices effect on performance of MSEs in Busia Town?

IV. JUSTIFICATION OF THE STUDY

The findings may benefit the government of Kenya especially industrialization and enterprise development ministry in formulating policies to cushion MSEs against financial crisis arising from poor financial management practices. The study findings may be adopted by MSE development agencies in Kenya in designing interventions to enhance the growth and development of micro and small enterprises. The study would also contribute to the existing body of knowledge on financial management practices for micro and small enterprises.

V. LITERATURE REVIEW

The study was anchored around the Resource Based View (RBV) theory which posits that an organizations performance is shaped by the unique combination of resources it has access to (Gottschalk 2007). These resources include both physical assets and also competencies. Resource based firm theory states that “unique organizational resources of both tangible and intangible nature are the real source of competitive advantage” (Gottschalk 2007). Wade and Hulland (2004) define six attributes of firm resources. Resource attributes which *ex ante* limit competition are value, rarity, appropriability, imitability, sustainability and mobility ex post limit competition. Wade and Hulland (2004) suggest that while some resources generate competitive advantages, others help sustain them. Resources, which generate competitive advantages, can be thought of as ex ante limitations to competition, whereas resources that sustain competitive advantages can be identified as *ex post* limitations to competition. Financial resources such as capital are a major source of competitive advantage in a firm because it enhances growth and investments. Therefore the success in performance of any firm, big or small can be attributed to the extent in which the resources are managed. In the context of the current study this implies that the financial resource management practices of MSEs are a key determinant of their success as firms.

Financial management practices and their impact on Firm Performance:

A number of studies have explored the impact of financial management practices, in whatever dimension, on firm performance recording varied results. Peel and Wilson (1996) investigated the capital budgeting and working capital practices of small firms in north England and reported that a relatively high proportion of small firms used quantitative capital budgeting and working capital techniques. Additionally, firms which used the more sophisticated discounted cash flow capital budgeting techniques, or which had been active in terms of reducing stock levels or the debtors’ credit period, on average tended to be more active in respect of working capital management practices. The importance of working capital management has been discussed by García-Teruel and Martínez-Solano (2007) and Thalassinos and Curtis (2005) on a sample of small and medium sized Spanish firms. They reported that managers can create value by reducing their inventories and the number of days for which their accounts are outstanding. Moreover, shortening the cash conversion cycle also improved the firms’ profitability.

In Europe, García-Teruel and Martínez-Solano (2010) analyzed the determinants of the trade credit granted and received on a panel of 47,197 SMEs over the period 1996–2002. They reported that firms with greater capacity to obtain resources from the capital markets, and more cheaply, granted more trade credit to their customers and that firms reacted by increasing the credit they grant in an attempt to stem falling sales. In Germany, Czarnitzki and Hottenrott (2011) analyzed the relation between working capital management and profitability of small and medium-sized enterprises and reported a non-monotonic (concave) relationship between working capital level and firm profitability, which indicates that SMEs have an optimal working capital level that maximizes their profitability.

An essential part in management of working capital lies in maintaining liquidity (cash flows) in day-to-day operations is to ensure smooth running of the business and that it meets its obligations (Deloof, 2003). Studies on liquidity and performance have mostly used ratios to measure the liquidity position producing reporting equivocal results. For instance, Raheman and Nasr (2007) reported a strong negative relationship between the current ratio and debt ratio and profitability of the firms while establishing a negative relationship between liquidity and profitability. Similarly, Benjamin and

Kamalavali (2006) established a negative association between financial performances and the current ratio, cash turnover ratio, current asset to operating income and leverage but a positive association between ROI and the quick ratio, debtors turnover ratio, current asset to total asset and growth rate. In his study, Dong (2010) focused on profitability, conversion cycle and its related elements reported that the firms' profitability and liquidity are affected by working capital management, with a very strong negative relationship being observed between the variables. This implied that decrease in the profitability occur due to increase in cash conversion cycle while a decrease in the number of days of account receivable and inventories increased the profitability.

Management of tangible assets is another critical element in the financial management practice of SMEs. By tangible assets, it is meant the physical resources which can be seen and evaluated (Wilk and Fensterseifer, 2003). Asset management in business involves the systematic integration of advanced and sustainable management techniques into a management paradigm or way of thinking, with primary focus on the long-term life cycle of the asset and its sustained performance, rather than on short-term, day-to-day aspects of the asset. Proper asset management enables SMEs to access asset based expansion financing from financial institutions. Evidence suggests that access to finance has a beneficial impact on business start-ups and growth. For instance, a review of empirical studies exploring business growth showed that of the five studies which examined the impact of startup capital on the growth performance of businesses, three found a positive relationship between start- up capital and growth though they do not necessarily provide evidence of a causal relationship (Butler and Cornaggia, 2009). Additionally, Aghion *et al*., (2007) find that higher finance development increases new firm entry into sectors which are heavily dependent upon external finance.

Another critical component of financial management among SMEs is financial reporting. Despite their economic importance, one of the challenges that has traditionally faced MSEs is lack of access to funding which according to Richard *et al*., (1991) is exacerbated by MSEs inability to generate and use quality accounting information. In the face of poor accounting or non-existence accounting information, good funds management is inhibited. However, this situation is fast improving. Richard *et al*., (1991) opines that improved accounting systems due to increased computerizing of accounting systems has elevated the standard of financial reporting in small businesses in North America. Consequent upon the installation and use of an accounting information system, satisfactory aggregation of the business activities is achieved in forms of records which enhances financial reporting. In their survey, DeThomas and Frederberger (1985) found that 81 percent of the small businesses at least produced some financial statements. Thomas and Evanson (1987) found among a study of 398 small pharmacies located in the states of Michigan, North Carolina, Nebraska Rhode Island and Washington that 94 percent prepared financial statements. Recently, banks practices all over the world have shown that accounting information has provided bases for evaluating SMEs for the purpose of making funds accessible to them (Ohachosim, 2012). This evidence at least points to the continued importance of financial reporting in the MSEs sector even though none of the studies have explicitly linked the practice to performance.

VI. RESEARCH METHODOLOGY

The study adopted a descriptive survey research design since sought to describe the ex post facto relationship among study variables based on respondents' reactions about the variables (Mugenda and Mugenda, 2003). The study was based on a population of 712 SMEs operating in busia town in 2016 (Busia County Licensing Office, 2015) out of which a sample of 88 MSEs were selected following the procedure by Nashua (2000). The sample was considered sufficient since it surpassed the 10 % adequacy criteria set by Gay (1992). Financial management practices were measured using a five point likert type interval scale while firm performance was measured in terms of profitability. Primary data was collected from these MSEs using a semi structured questionnaire which contained both open and closed ended questions. The questionnaire was piloted for validity and the Spearman-Brown Prophecy method of split half reliability used to test for reliability of the instruments which is on average less biased and therefore more accurate (Eisinga *et al*., 2012). The test gave a score above 0.7 threshold recommended by Gay (1992). Regression analysis was carried out to test the relationship between financial management practices and MSE performance, guided the following model:

$$Y_i = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots.. equation\ 1$$

Where Y_i is Firm performance, $X_{i's}$:*i*=1-4 are financial management indicators, β_0 is a constant, $\beta_{i's}$:*i=1-4* are slope coefficients and ε is a random error term.

VII. RESULTS AND DISCUSSIONS

81 of the questionnaires administered were returned which presents 92% response rate hence an adequate response rate for statistical reporting as suggested by Nulty (2008). Demographics characteristics of the respondents such as gender, marital status and highest level of education were ideal for this study. Male formed the majority of the respondents as they constituted 65.4% of the respondents while female were 34.6% of the respondents. The study revealed that most SMEs in Busia County are owned by male as compared to female. Majority of the respondents were married as they constituted 71.6% of the respondents while single were 28.4% of the respondents. The dominant category of married entrepreneurs has been found to have effect on the financial management practices.

TABLE I presents summary statistics of the data while TABLE II present correlations among variables.

TABLE I: DESCRIPTIVE STATISTICS OF VARIABLES

Variable	Obs.	Mean	S.E. Mean	Std. Deviation	Skewness	Kurtosis
Working capital management	81	3.730	0.110	0.960	-0.120	-0.630
Cash flow management	81	3.900	0.100	0.776	-0.556	-0.280
Asset management	81	2.600	0.100	0.880	-0.160	-0.610
Financial reporting	81	3.432	0.072	0.651	-0.439	-0.369
Firm performance	81	2.930	0.095	0.561	-0.697	-0.592

Source: Research data (2016)

TABLE II: CORRELATION COEFFICIENTS

Variable	[1]	[2]	[3]	[4]	[5]
[1] Working capital management	1				
[2] Asset management	.316**	1			
[3] Financial reporting	.330**	.391**	1		
[4] Cash flow management	.548**	.409**	.301**	1	
[5] Firm performance	.716**	.522**	.501**	.693**	1
**significant at 0.01 (two tailed); * significant at 0.05 (two tailed)					

Source: Research data (2016)

The main objective of this paper was to determine the impact of financial management practices on firm performance of MSEs. To attain this objective, the study used an additive regression model (equation 1) where all constructs of financial management practices, namely: working capital management; asset management; financial reporting; and cash flow management, were regressed against firm performance. The results are presented in TABLE III. The results revealed a statistically significant regression relationship between the predictors and criterion variables as shown by the F statistic which is statistically significant (Blackwell III, 2005; Hoe, 2008; Greene, 2008). As shown in the results in TABLE III, all the predictor variables entered in the model except the constant were statistically significant at 5 percent significance threshold that was adopted in this study. The financial management practices had a significantly positive effect on firm performance. This confirms the findings by García-Teruel and Martínez-Solano (2007) and Thalassinos and Curtis (2005) in Spain that financial management practices (working capital management) enhanced firm performance. Similar results were also reported by García-Teruel and Martínez-Solano (2010) and Czarnitzki and Hottenrott (2011) in Europe. Consistent financial reporting was exercised by the MSEs and this had a positive impact on performance as suggested by Richard *et al*., (1991) that financial reporting was beneficial to small firms at least as it enhanced access to financing.

However, the findings that cash flow management enhance significantly performance contradicted the findings by Raheman and Nasr (2007) who reported a strong negative relationship between the current ratio and debt ratio and profitability of the firms while establishing a negative relationship between liquidity and profitability. This was also the case in Benjamin and Kamalavali (2006) who reported a negative relation between financial performances and the current ratio, cash turnover ratio, current asset to operating income and leverage. Also contradicted are the findings by Dong (2010) who reported that the firms' profitability and liquidity are affected by working capital management, with a very strong negative relationship being observed between the variables.

TABLE III: REGRESSION MODEL ESTIMATIONS

Coefficients					
	Unstandardized coefficients		Standardized coefficients	t	Sig.
	B	Std. Error	Beta		
Constant	-.054	.340		-.159	.874
Working capital management	.363	.066	.411	5.504	.000
Cash flow management	.369	.084	.337	4.406	.000
Asset management	.173	.068	.178	2.525	.014
Financial Reporting	.255	.089	.195	2.856	.006

ANOVA and Model Summary				
	R[a]	.847	F change	48.313
	R Square	.718	Prob. (F change)	0.000
	Adjusted R Square	.703		

[a] Dependent variable: Firm Performance

Source: Research data (2016)

VIII. CONCLUSION

Based on the findings of this study, the following conclusions can be made; that financial management practices have significant effect on the performance of MSEs in Busia Town. In addition, the study established that working capital has significant positive strong effect on the performance of MSEs with specific practices like keeping track of the stocks and specifying credit limit. Furthermore, the study was able to determine that cash flow management practices have significant strong positive effect on the performance of MSEs with specific practices like analysis of business cash flows, analysis of cash outflows and analysis of the cash flow position of a business. Moreover, the study assessed that asset management practices had significant moderate effect on the performance of MSEs with practices such as up to date asset register and system for maintenance of assets ensures that assets are kept in the best condition until disposal. Finally, the study concluded that financial reporting practices like Reconciliation of books of accounts, preparing statement of business liabilities, Preparing cash flow statements and Preparation of tax statements had significant moderate effect on the performance of MSEs.

IX. RECOMMENDATION

Based on the findings and conclusions of this study, the following recommendations can be made. The overall recommendation is for MSEs which have not been using financial management practices to adopt them in their operations. This will enhance the business overall performance by more than 50%. MSEs need to revisit the use of working management capital with special reference to shorten the cash conversion cycle by ensuring quick resale of our goods and maintain an optimal working capital to enable a smooth running of their business. This will ensure that MSE there is sufficient working capital for business operations and will increase the MSE value

Moreover, basing on cash flow management practices, the study recommended that MSEs compare the near cash in with the cash payment obligations before making payment decisions this will ensure that that the organization doesn't risk running into a cash deficit which in turn would lead business running into overdrafts which are more expensive source of finance . In addition, on assets management practices, business should calculate depreciation of assets as well as allow for provision for depreciation of assets this will ensure that depleted assets are replaced timely and at reasonable value, also enable MSEs save in taxation as depreciation value are tax allowable .the study further recommended that MSEs should have laid down procedure for disposing assets nearing the end of life this will help MSE continue running and avoid higher costs that may accrue due to high rate of breakages of assets and escalating costs of repair. On financial reporting, the study recommended that MSEs should enhance the preparation of financial statements as it will enable business to have realistic result of its performance. Proper financial statement will give true and correct position of financial performance of the business.

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