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Relationship between Financial Restructuring Turnaround Strategy and Performance of Small and Medium Enterprises in Kenya

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Abstract: **The main objective of this study was to determine the relationship between financial restructuring turnaround strategy and performance of small and medium enterprises in Kenya. The total target population was 8604. A total of 375 respondents were used as the sample size for the study. Descriptive survey design and correlational research design were used in this study. This study tested the null hypotheses that financial restructuring has no relationship with the performance of SMEs in Kenya. The study found that financial restructuring turnaround strategy had significant influence on SMEs performance. The study therefore recommended that SMEs should adopt measures aimed at improving financial soundness of SMEs.**

Keywords: **Financial Restructuring, Turnaround Strategy, Performance.**

1. INTRODUCTION

In many of the cases, the interest burden is one of the important causes of decline among both the upcoming and the giant organisations alike. It may not be possible for any of these declining firms to turnaround without adequate financial turnaround strategy with the help of say banks and other related financial institutions. These changes significantly reduces the expenses of the firm. Simultaneously, strengthening finance function in the organisation is important. Cash flows need to be closely monitored and financial implications of all important decisions carefully evaluated. According to the study done by Scherrer (2003) it is clear that the aim of financial restructuring turnaround strategy is to develop and use the financial competencies of the business as an asset to enhance the competitiveness of the business. He further suggested that financial restructuring turnaround strategy is to develop and use the financial strength of the business as an asset to enhance the competitiveness of the business. Organisations adopt several such financial restructuring strategies as reduction in the par value of shares, obtaining loans at low rates of interest, postponement of maturity of debts, and conversion of debt into equity (Kumar, 2003). As severity of decline increased, the financial restructuring turnaround strategies should use more of asset reduction strategies rather than cost reduction (Howard, 2005).

Finance is the life blood of any business, hence, financial restructuring turnaround strategies play a significant role among others. This is in line with findings of Anand and Manimala (2007) who suggested that financial restructuring turnaround strategies are aimed at improving the liquidity, reducing investment and leverage, and more importantly controlling unproductive expenses. To mobilize resources the management can decide to persuade the investors to invest their funds in a declining firm. Obviously, it is not an easy task of raising more equity. In agreement with this preposition Turner and Radford (2003) on their part suggested that the affected firm can tie-up with another cash-rich firm which is convinced of its viability and is willing to invest in it. While asset and leverage reductions constitute one component of turnaround finance strategy, cost reduction is the other. The commonly employed financial strategy is reduction of costs in relation to administrative, especially manpower, travel and telephone overheads, and on special amenities. Hoffman (2009) also states that cost cutting is the key to successful financial turnaround. These two strategies are viewed as retrenchment strategies (Hambrick, 2010). Studies have identified financial restructuring strategy as an integral component of turnarounds (Igor, et al., 2006). Other studies such as the one done by Booma and Babson (2012) have found that firms

with successful financial restricting turnaround strategy have in the past reduced debt to manage cost of capital. The key is to identify non-performing or underperforming business units or products and quickly find buyers. The studies further suggested that sellers can use cash from liquidation to reduce debt or increase their cash balance. Well-managed companies always focus on cash and capital management where capital investment is cut down to the core. However, not all capital investments may be a non-priority. For example, one can take advantage of making an investment in real estate during an economic downturn.

2. STATEMENT OF THE PROBLEM

Bachmann (2009) conducted a study on sustainable performance increase and strategic turnaround management focusing on Romanian market and found out that ongoing turnaround management can be a successful key to achieve sustainable corporate performance improvement. Using a German case study, Mihail, et al., (2013) on the study of high performance work system in corporate turnaround realized that rising employee productivity and sales over the last decade have been brought about by high commitment work practices to corporate change, which has enhanced performance outcome. These studies focused majorly on the turnaround strategies in general leaving a gap of what is the relationship between each turnaround strategy and performance of the organizations. The current study therefore aimed at filling this gap by focusing on the relationship between financial turnaround strategy and performance of small and medium enterprises in Kenya.

3. LITERATURE REVIEW

Scherrer (2003) observed that financial restructuring turnaround strategy helps in developing financial competencies of the business and is used as an asset for enhancing the competitiveness of the business. The main aim of financial restructuring turnaround strategy is to develop and use the financial strength of the business as an asset to enhance the competitiveness of the business. According to Kumar (2003), organisations usually adopt financial restructuring strategies as reduction in the par value of shares, obtaining loans at low rates of interest, postponement of maturity of debts, and conversion of debt into equity. Cost cutting is the key to successful financial turnaround (Hoffman, 2009). Igor, et al., (2006) identified financial restructuring strategy as an integral component of turnarounds. In the context of organizational financial performance, performance is a measure of the change of the financial state of an organization, or the financial outcomes that results from management decisions and the execution of those decisions by members of the organization. Organizational performance can be judged by many different constituencies, resulting in many different interpretations of successful performance. Simpson (2006) observed that there is a positive link between a company's financial performance and its approach to marketing. Any organization wishing to succeed should target the ideal standard of performance that include ethical considerations, energetic behavior, and proven competencies that guarantee desired results (Gary, 2003). De Waal, et al., (2012) reiterates that high performance profile is occasioned by a four-dimensional factor structure consisting of managerial behaviours, environmental influences, personal qualities and organisational demands. In support of this view, Barney (2001) states that the concept of organizational performance is based upon the preposition that an organization is the voluntary association of productive assets, including human, physical, and capital resources, for the purpose of achieving a shared purpose.

4. RESEARCH METHODOLOGY

The research designs that were used in this study were descriptive survey design and correlational research design. The research population in this study were 8,604 fast moving consumer goods SMEs. Stratified random sampling was adopted in this study. The study used both primary and secondary data. Primary data was collected directly from the respondents and used to analyze the relationships that were being examined in this study. Secondary data was used to acquire information on the performances of the small and medium enterprises. This information was obtained from previous evaluation reports carried out by the owners of the enterprises and from the books of accounts. Data for the current study was collected by administering the questionnaires to a sample of 375 respondents. Pearson’s Product Moment Correlation Coefficient (r) was used in this study to analyze the linear relationship between the main predictor variables and the dependent variable.

5. RESULTS AND DISCUSSION

The main objective of the study sought to examine the relationship between financial restructuring turnaround strategy and performance of SMEs. To achieve this, the respondents were required to give their rating on a five point Likert scale.

Since the data was in ordinal scale percentage was used to summarize the responses as shown in Table 1. 68.4% of the respondents agreed that they are familiar with financial restructuring turnaround strategy in their business, 22.5% strongly agreed. With a mean score of 1.9 and standard deviation of 0.6, it can be concluded that the majority of the SMEs do practice financial restructuring turnaround strategy.

27.2% of the respondents agreed that conversion of debt to equity is necessary for the company and 13% of the respondents strongly agreed on the same. This makes 40% of the respondents cumulatively in an agreement that conversion of debt to equity is necessary for the company. With a mean score of 3.2 and standard deviation of 1.4, the study concluded that the majority of the respondents agreed that conversion of debt to equity is necessary for the company. Thirdly, 47.8% disagreed that conversion of equity into debt helps in turning around the company into a profit making entity. This has also been confirmed by a value of 3.2 and 1.2 for both the mean score and standard deviation respectively.

41.1% agreed that cooperation or collaboration benefits the company in a greater way than those from individual efforts, 26.9% strongly agreed on the same. The study therefore concluded that the majority of the respondents are in an agreement that cooperation or collaboration benefits the company in a greater way than those from individual efforts. This has been corroborated by the mean score of 2.3 and 1.1 standard deviation. 56% agreed that strategic alliances creates or maintains strategic choices for the company, 22.2% strongly agreed. This cumulatively translates to 78% of the respondents. This result indicates that the majority of the respondents were in an agreement that strategic alliances creates or maintains strategic choices for the company. 59.8% agreed that strategic alliance help in mitigating significant financial risks facing our business, 19.3% strong agreed. This result indicates that the majority of the respondents were in an agreement that strategic alliance help in mitigating significant financial risks facing businesses.

The Cronbach Alpha Reliability Coefficient for these six items that were used to measure the relationship between financial restructuring turnaround strategy and performance was 0.70. That the reliability coefficient for these items was 0.70 indicates internal consistencies of the items that were used to indicate the direction of this variable in respect to the research objectives. The descriptive statistics are shown in Table 1.

Table 1: Descriptive Statistics between Financial Restructuring Turnaround Strategy and Firm Performance

	Percentage (%) n=316						
	Strongly Agree	**Agree**	**Neutral**	**Disagree**	**Strongly Disagree**	**Mean**	**Std. Deviation**
I am familiar with financial restructuring in this business	22.2	68.4	7	2.5	0	1.9	0.6
Conversion of debt into equity is necessary for company	13	27.2	9.5	24.1	26.3	3.2	1.4
Conversion of equity into debt helps in turning around the company into a profit making entity.	11.4	18	14.2	47.8	8.5	3.2	1.2
Cooperation or collaboration benefits our company in a greater way than those from individual efforts.	26.9	41.1	11.1	18	2.8	2.3	1.1
Strategic alliances creates or maintains strategic choices for our company	22.2	56	19	0	2.8	2.1	0.8
Strategic alliance help in mitigating significant financial risks facing our business	19.3	59.8	18	0	2.8	2.1	0.8

The literature that was reviewed in this study as well as theoretical reasoning associated financial restructuring strategy with organizational performance. Organizational performance in this case, was indicated by profitability and return on assets while financial restructuring turnaround strategy was indicated by conversion of debt into equity and strategic alliances. Following the theoretical arguments, the following hypothesis was formulated and tested: There is no significant relationship between financial restructuring turnaround strategy and performance of small and medium enterprises in Kenya. The model summary in Table1, demonstrates the coefficient of determination as indicated by R squared to be 0.426 implying that 42.6% of the SME performance is explained by financial restructuring turnaround strategy while the other factors explains the remaining proportion.

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Table 2 Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.653a	0.426	0.396	0.117	2.298

a Predictors: (Constant), Financial

b Dependent Variable: Firm performance

In Table 3 the ANOVA was used to show the overall model significance. Since the p-value is less than 0.05, then financial restructuring turnaround strategy had a significant explanatory power on SME performance ($F = 38.298$ and p value <0.05).

Table 3 ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	372.007	1	372.007	38.298	.000b
	Residual	3050.003	314	9.713		
	Total	3422.009	315			

a Dependent Variable: Firm performance

b Predictors: (Constant), Financial

From Table 4, regression equation can be written as:

GTP = 4.851 + 1.087 Financial Restructuring Turnaround Strategy

The regression equation shows that when financial restructuring turnaround strategy is held at a constant zero, SME performance would be 4.851 units. There is a positive and significant relationship between financial restructuring strategy and SMEs performance in Kenya. A unit increase in financial restructuring strategy increases SMEs performance by 1.087 units. Since the P value was less than 0.05 then there is enough evidence to warrant rejection of the null hypothesis and conclusion that there is a significant relationship between SMEs performance and financial restructuring strategy.

Table 4 Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
		B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1	(Constant)	4.851	0.175		27.67	0.00		
	Financial	1.087	0.176	0.33	6.189	0.00	1	1

a Dependent Variable: Firm performance

The study aimed at assessing the relationship between financial restructuring turnaround strategy and performance of small and medium enterprises in Kenya. The null hypothesis was stated as**:** There is no significant relationship between financial restructuring turnaround strategy and performance of small and medium enterprises in Kenya. The results of this findings led to rejection of null hypothesis thus favoring alternative hypothesis confirming the results shown by Osoro (2014). Osoro (2014) study of financial restructuring on the financial performance on eleven (11) Commercial Banks in Kenya reported a positive relationship. As argued by Scherrer (2003) on the book entitled, industrial market structure and economic performance, financial restructuring is used to enhance competency in business which would see the business remaining at competitive advantage. Further, as explained by the study conducted by Booma and Babson (2012) on the study of a capability-driven turnaround strategy for the current economic environment, in the past successful financial restructuring turnaround strategy have been seen to reduce debt through good management of cost of capital.

Similarly, Anand and Manimala (2007) on the study of sustainability of the Indian railways turnaround: a state theory perspective, found out that financial restructuring strategy had improved the liquidity, reduced investment and leverage and controlled unproductive expenses which show organizations' performance improve significantly. Kumar (2003) on the study of industrial sickness: causes and remedies was for the suggestion that organization need to adopt several financial restructuring. This was braced by majority respondents (47.4% and 56.3%) who either supported conversion of debt into equity or equity into debt respectively. The synergy that emerge as result of cooperation and collaboration was also found to be helpful to the organization with aim to restructure financially so as to achieve increased performance.

Agreeing with Turner and Radford (2003) allusion of merging of firms standing to benefit from each other in their investment, majority of the respondents (68%) showed their support for cooperation or collaboration with others. Surprisingly, most participants felt that any form of strategic alliance had no significant impact of mitigating financial risks facing their business. Riany, Musa, Odera & Okaka (2012) study of Kenya mobile phone service providers too found a favorable effect of financial restructuring on firm performance. Riany, et al., (2012) results showed that financial restructuring impacted greatly on a company on market share. This study supported Eby and Buch (1998) prepositions on the study of the impact of adopting an ethical approach to employee's dismissal during corporate restructuring that organization financial restructuring is beneficial in different ways that are not limited to lowering operational costs and implementation of other strategies.

Debt management being part of financial restructuring (Cascio, 2002) on the book responsible restructuring: creative and profitable alternatives to layoffs in the USA, allows a private or public firms undergoing cash flow problems and financial distress, to be in position reducing and renegotiating delinquent debts to restore liquidity and enhance rehabilitation so that firms can carry out operations. Cascio (2002) contends that the investment pattern of a company which relates to ability of corporations to identify the various investments opportunities that would lead to higher returns is part of the restructuring procedure. It can then be said that financial restructuring may be met with the intention to improve liquidity, minimize the cost of capital, mitigating risk, avoid loss of control, and maximize shareholder wealth. This is according to Pfeiffer and Salancik (2003) on the study of the external control of organizations: a resource dependence perspective conducted in California.

6. CONCLUSION

The study found that financial restructuring turnaround strategy had significant influence on SMEs performance. There is need for SMEs to continuously evaluate their financing strategy as such to ensure to check optimality and it can be in a position to meet all the financial costs associated with the specific source of financing. More so, there is need for development of a financial guideline which will be used by SMEs to evaluate their financial soundness. This is in line with the empirical literature like Osoro (2014) on the study of financial restructuring on the financial performance on eleven (11) Commercial Banks in Kenya reported a positive relationship between financial restructuring turnaround strategy and performance.

7. RECOMMENDATION

Findings from the study depicted that financing turnaround strategy is necessary for SMEs performance. It is recommended that SMEs should adopt measures aimed at improving financial soundness of SMEs. There is need to convert debt capital into equity and form strategic alliances geared towards finance cost minimization. The management should continuously evaluate the alternative financing strategies available as such to ensure they remain profitable.

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