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IMPLICATION OF FINANCIAL CHALLENGES ON PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KISUMU CITY, KENYA

Reuben Atela Orinda
Maseno University, Kisumu, Kenya.
orinda.reuben@yahoo.com

Luther Otieno
Department of Finance and Accounting, School of Business
University of Nairobi.
otienoluther@yahoo.com

Abstract

The pace for innovation is continuously increasing in developed world and market. The major important issues facing many Small and Medium Enterprises (SMEs) is how to foster and increase growth, innovations and profitability that is based on limited resources, financial and non – financial challenges. Some of financial challenges facing SMEs in their operations are lack of finance and limited access to credit, high interest rate, laws and regulations. Such challenges have implications on the performance of SMEs daily operation. It impedes growth, financial innovations and profitability. The objective of the study was to establish implications of financial challenges on performance of SMEs. The study was conducted through cross sectional survey. Systematic sampling was done in order to come up with representative sample that could eliminate the possibility of biasness. Data was collected through close ended questionnaire developed in likert scale and analyzed through descriptive statistics in line with objective of the study. The results indicate that, financial challenges have implications on growth, profitability and financial innovations.

Key words: enterprise, performance, financial challenges, Small and Medium Enterprises.
[1*]Corresponding author

I. INTRODUCTION

Small and Medium Enterprises (SMEs) performances are the drivers of economic growth in developing countries [5][6]. SMEs are policy priority for many countries, given their significance in terms of economics development and make an important contribution in employment [5][6]. Financial access is critical for SMEs growth and development, availability of external finance is positively associated with productivity and growth. However, access to

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financial services remains a challenge to SMEs growth and development especially in emerging economies [7].
Finance is often reported as the major obstacle constraining SMEs growth and development [11]. SMEs struggle to make investments in order to accelerate productivity and competitiveness of their enterprises [11]. Failure to adopt ICT processes has made SMEs not to reap the benefits of financial innovation. Adoption of technology may enable SMEs to access foreign market and information and therefore, information communication technology is considered a driver to SMEs economic Development [8]. While access to finance is not sufficient condition for SMEs firms to innovate, upgrade and become more productive and participate in global market, it is one of the keys to unlocking their potential. Raising investment and productivity levels in SMEs are crucial in strengthening recovery and ensure growth pattern have a solid foundation [3]. More funding indicates that SMEs with more trade credit tend to improve their profitability [4].

Splitting big firms into small firms or subsidizing small firms will not lead to faster growth. More fundamental reforms must first be instituted to tackle the underlying reasons why firms do not fulfill their growth potential [1]. The ability to access finance may be one of the reasons why they do not see a robust correlation between SMEs Prevalence and economic growth [1].

Financial development helps small firms the most. Both firm level and industry level studies suggest that small firms do relatively better compared to large firms in countries with better developed financial institutions [1]. With financial development, small firms grow faster since their financing constraints are relaxed to a greater extent. Furthermore, industrial sectors that should naturally have a disproportionately large number of small firms also grow faster with financial development thus suggesting that it is the small firms that benefit the most [2]. Lack of a well functioning financial markets and underdeveloped legal system make it very difficult for firms to grow to their optimal size since outside investors cannot prevent expropriation by corporate insiders. Finance is important for SMEs strategies and if it is optimal for firms to stay small in countries, with underdeveloped institution, simply subsidizing SMEs may not at best ineffective, and at worst, counterproductive [1].

While the overall credit condition has been accommodative, credit growth has remained constant especially for small and medium enterprises [9]. Firm level data and sectorial corporate balance sheet shows that many SMEs have faced structural challenges of high leverage and low profitability [9]. The global financial crisis has weakened the financial position across SMEs, particularly for those with low credit worthiness. These challenges are closely related to low availability of risk capital and the pervasiveness of credit support measures [9]. Supply of risk based capital, costly government support measures should be phased out and SMEs restructuring be accelerated. Efforts are also needed to deepen capital Market to enhance risks, capital availability and address regulatory barriers to starting a business. In that regard addressing SMEs weaknesses would improve private investment, enhance firm productivity and lift growth [9].

SMEs can be more flexible and responsive to new market opportunity and economic recession if their capacity to access funds can be enhanced. In the period of high unemployment, many former employees start their own enterprises, relying on their experience, education and managerial skills. Furthermore, large firms increasingly place part of their work outside the organization providing a further incentive for the creation of new small firms. Since sub contracting and outsourcing can reduce production cost [10]. SMEs grow and develop, they face strains on their profitability that impact on a key performance indicator return on investment (ROI). Further any deterioration in Return on Investment will compromise a firm's ability to obtain finance for future expansion [10].

II. OBJECTIVE OF THE STUDY

Small and Medium enterprises plays a critical role in development of economy. The success of SMEs lies on strategies employed to realize marketing, innovation and financial goal. The study in this area is important in development of knowledge, expertise and intellectual capabilities. The study seeks to establish implication of financial challenges on performance of small and medium enterprises in Kisumu City, Kenya.

III. MATERIALS AND METHODS

An inexpensive sectional survey design that takes little time to conduct was used in the study. It also estimated prevalence of outcome of interest and the sample was taken from the whole population statistical inference of the population was also studied. Probability sampling was used to carry out the study. A structured close ended questionnaire developed in likert scale was used to collect data from the respondents. Data was collected from Formal and Informal Enterprises. The study adopted descriptive analysis in accordance with the objectives of the study.

Result

After review and analysis, the following outcome was realized. Table 1 shows the results of implication of lack of adequate finance and limited access to credit on growth.

Table 1 Lack of adequate finance and limited access to credit

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	69	81.2	81.2	81.2
	Agree	15	17.6	17.6	98.8
	Neither agree nor disagree	1	1.2	1.2	100.0
	Total	85	100.0	100.0	

81.2% of the respondents strongly agree that lack of adequate finance and limited access to credit affects the growth of small and medium enterprises in Kisumu City while 17.6% agree. 1.2% neither agrees nor disagrees.

Table 2 Indicate implication of interest rates on growth.

Table 2 High Interest Rate.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	36	42.4	43.4	43.4
	Agree	33	38.8	39.8	83.1
	Disagree	14	16.5	16.9	100.0
	Total	83	97.6	100.0	
Missing	System	2	2.4		
Total		85	100.0		

43.4% of the respondents strongly agree that high interest rate affects growth of small and medium enterprises in Kisumu city, 39.8% agree and 16.9% disagree.

The implication of laws and regulations on growth of SMEs are indicated in table 3

Table 3 Laws and regulations.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	33	38.8	39.8	39.8
	Agree	29	34.1	34.9	74.7
	Neither agree nor disagree	4	4.7	4.8	79.5
	Disagree	12	14.1	14.5	94.0

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	Strongly Disagree	5	5.9	6.0	100.0
	Total	83	97.6	100.0	
Missing	System	2	2.4		
Total		85	100.0		

39.8% of the respondent strongly agrees that new laws and regulation affects growth of small and medium enterprises in Kisumu City, 34.9 agree, 4.8% neither agree nor disagree, 14.5% disagree and the remaining 6% strongly disagree.

Table 4. Explains implications of lack of adequate finance and limited access to credit on profitability.

Table 4 Lack of adequate finances and limited access to credit.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	53	62.4	62.4	62.4
	Agree	26	30.6	30.6	92.9
	Neither agree nor disagree	3	3.5	3.5	96.5
	Disagree	2	2.4	2.4	98.8
	Strongly Disagree	1	1.2	1.2	100.0
	Total	85	100.0	100.0	

62.4% of the respondents strongly agree that lack of adequate finance and limited access to credit affects profitability of small and medium enterprises in Kisumu City. 30.6% agree, 3.5% neither agree nor disagree and 1.2% disagree.

In table 5, Show the result on implication of interest rates on profitability is explained.

Table 5 High Interest rate.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	37	43.5	47.4	47.4
	Agree	19	22.4	24.4	71.8
	Neither agree nor disagree	1	1.2	1.3	73.1
	Disagree	20	23.5	25.6	98.7

	Strongly Disagree	1	1.2	1.3	100.0
	Total	78	91.8	100.0	
Missing	System	7	8.2		
Total		85	100.0		

47.4% of the respondents strongly agree that high interest rates affects profitability of small and medium enterprises in Kisumu City, 24.4% agree, 1.3% neither agree nor disagree, 25.6% disagree and 1.3% strongly disagree.

The results of data analysis on implications of laws and regulations on profitability are explained in table 6.

Table 6 Laws and regulations.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	31	36.5	37.3	37.3
	Agree	30	35.3	36.1	73.5
	Neither agree nor disagree	2	2.4	2.4	75.9
	Disagree	17	20.0	20.5	96.4
	Strongly Disagree	3	3.5	3.6	100.0
	Total	83	97.6	100.0	
Missing	System	2	2.4		
Total		85	100.0		

Majority of the respondents 37.3% strongly agree that new laws and regulation affects profitability of small and medium enterprises, 36.1% agree, 2.4% neither agree nor disagree, 20.5% disagree and 3.6% strongly disagree.

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Table 7 Indicates implication of lack of adequate finance and limited access to credit on innovation.

Table 7 Lack of adequate finance and limited access to credit.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	59	69.4	72.8	72.8
	Agree	20	23.5	24.7	97.5
	Neither agree nor disagree	1	1.2	1.2	98.8
	Disagree	1	1.2	1.2	100.0
	Total	81	95.3	100.0	
Missing	System	4	4.7		
Total		85	100.0		

72.8% of the respondents strongly agree that lack of finance and limited access to credit affects financial innovation for small and medium enterprises in Kisumu City, 24.7% agree, 1.2% neither agree nor disagree and 1.2% disagree.

Table 8 shows results of analysis of implication of high interest rate on innovation.

Table 8 High Interest rate.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	28	32.9	37.3	37.3
	Agree	35	41.2	46.7	84.0
	Neither agree nor disagree	1	1.2	1.3	85.3
	Disagree	11	12.9	14.7	100.0
	Total	75	88.2	100.0	
Missing	System	10	11.8		
Total		85	100.0		

37.3% of the respondents strongly agree that high interest rates affects financial innovation of small and medium enterprises in Kisumu City, 46.7% agree, 1.3% neither agrees nor disagree, and 14.7% disagree.

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Table 9 indicates implication of laws and regulation on innovation.

Table 9

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	30	35.3	39.0	39.0
	Agree	27	31.8	35.1	74.0
	Neither agree nor disagree	3	3.5	3.9	77.9
	Disagree	13	15.3	16.9	94.8
	Strongly Disagree	4	4.7	5.2	100.0
	Total	77	90.6	100.0	
Missing	System	8	9.4		
Total		85	100.0		

39.0% of the respondents strongly agree that new laws and regulation affects financial innovation of small and medium enterprises, 35.1% agree, 3.9% neither agree nor disagree, 16.9% disagree and finally 5.2% strongly disagree.

IV. RESULTS AND DISCUSSIONS

From the foregoing analysis, it can be deduced that, financial challenges have implication on performance of small and medium enterprises. According to empirical study, the implication can be categorized into growth, profitability, and financial innovations. The data indicate that, 81.2% of the respondents strongly agree that lack of adequate finance and limited access to credit has implication on growth, 17.6% agree and 1.2% neither agrees nor disagrees. 43.4% of the respondents strongly agree that interest rates has implication on growth with 39.8% agree and 16.9% disagree. 39.8% of the respondents strongly agree that laws and regulation affects growth of SMEs with 34.9% agree, 4.8% neither agree nor disagree, 14.5% disagree and 6% disagree. This findings agree as in [11][1][2][9]. The result indicates that, financial challenges have implication on growth and development of SME. In order for the government to improve economic growth, reduce unemployment and deepen financial inclusivity, it should prioritized policy orientation toward liberalizing and addressing financial challenges.

Majority of respondents agreed that financial challenges has implication on profitability with 62.4% strongly agree that lack of adequate finance and limited access to credit has implication on profitability with 30.6% agree, 3.5% neither agree nor disagree, 2.4% disagree and 1.2% strongly disagree. 47.4% of the respondents strongly agree that high interest rates affects profitability with 24.4% agree, 1.3% neither agree nor disagree, 25.6% disagree and 1.3% strongly disagree. 37.3% strongly agree that laws and regulation has an implication on profitability with 36.1% agree, 2.4% neither agree nor disagree, 20.5% disagree and 3.6% strongly disagree. This finding corresponds as in [4][10]. This show that properly managed financial challenges enhances productivity and can lead to accelerated economic growth for the country.

On financial innovation, 72.8% of the respondents strongly agree that lack of adequate finance and limited access to credit affects financial innovation of SMEs, with 24.7% agree, 1.2% neither agree nor disagree,1.2% disagree. 37.3% of the respondents strongly agree that high interest rates affects financial innovation, with 46.7% agree, 1.3% neither agree nor disagree and 14.7% disagree. 39.0% strongly agree that laws and regulations has implication on innovation with 35.1% agree, 3.9% neither agree nor disagree, 16.9% disagree and 5.2% strongly disagree. This finding corresponds with empirical studies as in [8][3]. The result indicates that, without sufficient capital, SMEs cannot invest in research and development activities which are very critical for innovation and development. Mitigation of financial challenges is a prelude to innovative products and improving performance of SMEs.

V. CONCLUSION AND RECOMMENDATION

The objective of the study was to establish implication of financial challenges on performance of SMEs. Based on the findings,

I. Financial challenges have implications on growth, profitability and financial innovations.

II. The National and County Government should develop a clear policy framework to address these challenges to mitigate severity in terms of growth, profitability and innovation. The policy infrastructure should address formulation of favorable policies that would allow SMEs to improve their performance.

III. For the purpose of intellectual and knowledge, other researchers should look into area of lease financing and SMEs. This area may provide a fertile ground to understand the implication of lease financing on SMEs performance.

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