

Effects Of Financing Decisions On Performance Of Small Business Enterprises In Kenya

Osoro Geoffrey Ondicho
Email: geoffreyondicho@gmail.com
Mount Kenya University
P.O BOX 342-01000,
Thika.

Onchangwa Gilbert Achochi
Email: onchangwagilbert@gmail.com
Jomo Kenyatta University of Agriculture and
Technology
P.O BOX 00200-62000,
Nairobi, Kenya.

Dr. Nyariki, Kennedy Okemwa
Email: kokemwa@mku.ac.ke
Mount Kenya University
P.O BOX 342-01000,
Thika.

*Responding author: Email: onchangwagilbert@gmail.com

Abstract—Many small business enterprises perform poorly all over the world. The problem is rampant in Kenya where many small firms continuously experience a downward trend in performance. Many factors have been cited in literature for mass failure of these firms. However, the effects of financing decision on performance of small business enterprises in Kenya remain an enigma. Hence, the study sought to establish the effects of financing decisions on performance of small business enterprises in Kenya. The study which was hinged on investment theories adopted a descriptive research design. A population of all the registered 513 small business enterprises in Nyamira County were targeted. Simple random sampling was used to select a random sample of 154 respondents. Secondary data was obtained from annual reports and financial statements of small business enterprises. Primary data was collected using both closed and open ended questionnaires. Simple linear regression analysis was used to model the relationship among the study variables. On the basis of the sample data the study found that financing decision had a significant positive relationship with performance of SMEs. The results of this study are expected to mitigate losses through establishing robust financial management techniques for use in under-performing small business enterprises in Kenya. Moreover, the study could act as a platform for the survival of these firms as well as help them in the assessment of their financial conditions in case of rescue in order to achieve vision 2030 on financial services which is to create a successful and globally competitive financial sector capable of promoting high levels of saving and financing for Kenya's investment needs.

Keywords—Financing, Performance, Decision

1. INTRODUCTION

A small and medium enterprise (SME) is an enterprise which employs fewer than 250 persons and which has an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro (Soini & Veselli, 2011). Governments throughout the world are turning their attention to small and medium scale business enterprises (SMEs) and this is because attempts to promote economic progress by establishing large industries have usually failed to improve the lives of the majority of population concerned. Large firms like multinationals are reluctant to invest in areas with low buying power. The large companies assume that people with low incomes have little to spend on goods and services and that what they do spend goes to basic needs like food and shelter (Prahalad & Hammond, 2002). Hence, SMEs are viewed as important vehicles for even and equitable economic development. Global giant economies like the US, Britain, Germany, had a footing in SMEs venture (Kotler, 2008). Similarly, the giant cement manufacturing concern in the world, Lafarge, started in 1950 by manufacturing one bag of cement a day (Breneissen, 2000) but now they manufacture 1.5 million bags of cement per day. In Kenya, SMEs play an important role in the economy (Wanjiku, 2013). For instance, SMEs contributed over 50% of new jobs created in the year 2005 (Economic Survey, 2006). The sector contributed to economic development by providing employment, reducing poverty, embracing entrepreneurship culture and providing intermediary role in trade (Oketch, 2000).

Financing decisions involve the acquisition of funds to be used for investing and financing day – to- day operations. Dividend decisions relate to how much to pay out as dividends to shareholders and how much to retain for firm expansion.

A company's operations can be financed from outside of the business by incurring debts or by selling ownership interests. Financing decisions become very essential since each method of financing obligates the business in different ways. A firm can raise funds from two sources. These are equity and debt (Pandey, 2005). Equity is obtained through sale of shares which represent ownership rights of their holders. If managers decide to borrow funds (use of debt) the borrowed funds must be repaid within a specified period of time. Creditors do not share in the control of profits of the borrowing firm. They make money available to the firm as loan or debt and retain title to the funds lent (Pandey, 2005). The amount of interest paid by a firm is a deductible expense for computing corporate income taxes (Pandey, 2005). Hence, the interest provides tax shield to a firm which is valuable to a firm. However, if managers decide to raise funds by selling ownership interests (equity financing) the funds don't have to be paid back. Only that the sale dilutes the control of the current owners. A company can also obtain equity funds by retaining earnings available for shareholders. The retained earnings also called internal equity are undistributed profits of equity capital (Pandey, 2005). The mix of debt and equity is called the firm's capital structure. The firm's financial manager must obtain the optimum capital structure. A firm's capital structure is considered optimum when the market value of shares is maximized (Pandey, 2005).

In dividend decisions, the financial manager must decide whether the firm should distribute all profits or retain them, or distribute a portion and retain the balance (Pandey, 2005). The fraction of profits allocated as dividends is known as dividend- payout and that fraction retained is called the retention ratio. Firms should determine dividend policy on the platform of its effect on shareholders' value. The optimum dividend policy is that which maximizes the market value of the firm's shares.

1.1 STATEMENT OF THE PROBLEM

Financing decision is expected to boost performance of SMEs whose major objective is stakeholder wealth maximization. However, in Kenya, SMEs continuously face a downward trend in performance. This situation is confirmed by Wanjiku (2013) who state that there is a higher rate of failure in SMEs than large businesses. SME investors think of themselves as rational and logical but when it comes to investing, their emotional inclinations, ingrained thought patterns and psychological biases, colour how they perceive the world and how they make decisions (Jagongo & Mutswenje, 2014). Many studies have been done on SMEs. According to Deloof (2003) efficient management of working capital is crucial for prosperity and survival of small businesses in Canada, England and Australia. Padachi (2006) has shown that above 20% of small firm failures in the United Kingdom was due to irrecoverable debts or poor receivable management. In Kenya many small business enterprises continue to go under. It is not

clear if the failure is caused by poor financing decisions. Many studies have identified factors that cause the mass failure in small business enterprises. However, literature on the effects of financing decisions on performance of small business enterprises is limited. It is through the understanding of the effect of financing decisions on performance of small business enterprises that what causes failure of the enterprises can be determined and possibly mitigated in order to motivate the development of the enterprises. This can enable the achievement of vision 2030 on financial services which is to create a successful and globally competitive financial sector capable of promoting high levels of saving and financing for Kenya's investment needs. Hence, this study sought to establish the effects of financing decisions on performance of small business enterprises in Kenya.

1.2 OBJECTIVE

To determine the effects of financing decisions on performance of small business enterprises in Kenya

HYPOTHESIS

H_{01} : financing decisions have no effect on performance of small business enterprises in Kenya

H_{A1} : financing decisions have an effect on performance of small business enterprises in Kenya

2.3 Conceptual Framework

The study's dependent variable will be performance which will be measured in terms of profitability in small business enterprises. The independent variables will be financing decisions, investment decisions and portfolio diversification. Government policy will moderate the relationship between dependent variable and independent variables. This interplay between the dependent variable and the independent variables is shown in figure 1.

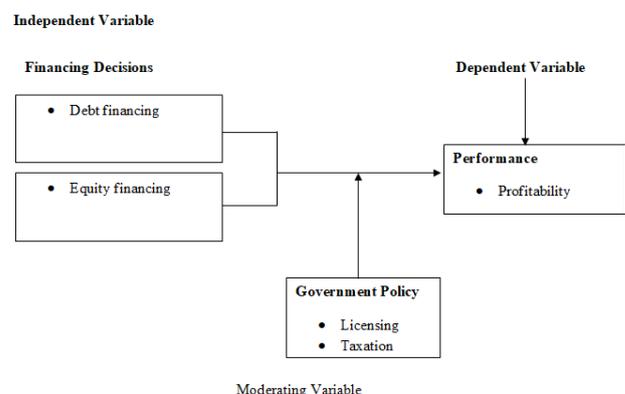


Figure 1: Conceptual Framework

1.3 METHODOLOGY

The study hinged on investment theories adopted a descriptive research design. A population of all the registered 513 small business enterprises in Nyamira County was targeted. Simple random sampling was used to select a random sample of 154 respondents. Secondary data was obtained from annual reports and financial statements of small business enterprises. Primary data was collected using both closed and open ended questionnaires. Simple linear regression analysis was used to model the relationship among the study variables. SPSS computer software helped to analyze data. The relationship between financing decisions and performance of small business enterprises was believed to obey a regression model of the form: $y = \beta_0 + \beta_1x + \mu$, where y = performance of small business enterprises, x = financing decisions, β_0 is the intercept term β_1 is the beta coefficient.

1.4 RESULTS AND DISCUSSIONS

The researcher used the loans advanced to SMEs to represent the effect of debt on performance of SMEs. Performance was measured by profitability of SMEs. The SPSS output for the data on performance and debt, was shown in **table 4.1**

Table 4.1 Effect of debt on performance of small business enterprises in Kenya

Model	Coefficients ^a			t	sig.
	Unstandardized Coefficients		Unstandardized Coefficients		
	B	Std. Error	Beta		
(Constant)	122.952	35.194		3.494	.001
DEBT	1.057	.060	.817	17.494	.000

a. Dependent Variable: PERFORMANCE

From table 4.1 the regression constant term was 122.952, coefficient for debt was 1.057. Hence the regression model was $Y = 122.952 + 1.057X + e$. The model shows that there is a positive relationship between debt and performance. An increase in debt by 1% leads to an increase of about 105.7% in profitability on average. Debt was used as an indicator of a financing decision.

The researcher also used equity as an indicator of financing decision. The regression output for the effect of equity on performance is shown on **table 4.2**

Table 4.2 Effect of equity on performance of small business enterprises in Kenya

Model	Coefficients ^a			t	sig.
	Unstandardized Coefficients		Unstandardized Coefficients		
	B	Std. Error	Beta		
(Constant)	431.913	45.476		9.498	.000
EQUITY	.425	.071	.436	5.973	.000

a. Dependent Variable: PERFORMANCE

From table 4.2 the constant term was 431.913, while 0.037, 0.425 was the regression coefficient. The model for equity and performance of small business enterprise was $Y = 431.913 + 0.425X + e$. The

model showed that there is a positive relationship between performance of SMEs and equity financing decision. Furthermore, from the model, an increase in equity financing by 1% led to an increase in profitability by about 42.5% on average.

1.6 CONCLUSIONS

From the foregoing it follows that debt and equity have a positive relationship with performance of small business enterprises in Kenya. Therefore, increase in debt in a firm's capital structure increases a firm's performance. Moreover, increase in equity in a firm's capital structure increases the firm's performance. From the findings debt capital was found to contribute more to a firm's performance. This perhaps was because debt capital is cheaper since it has interest tax shield compared to equity capital.

REFERENCES

Deloof, M. (2003). Does Working Capital Management Affect Profitability of Belgian Firms. *Journal of Business, Finance and Accounting*, 30, 573-587.

Jagongo, A., & Mutswenje, v. (2014). A survey of the Factors Influencing Investment Decisions: The case of Individual Investors at the NSE. *International Journal of Humanities and Social Sciences Vol. 4 No. 2*

Oketch, H. O. (2000). Micro and Small Enterprises in Kenya: Agenda for improving the Policy Environment. ICEG. Nairobi: ICEG.

Padachi, K. (2006). Trends in Working Capital Management and its Impact on Firms' Performance: An Analysis of Mauritian Small Manufacturing Firms. *International Review of Business Research Papers*, 2, 45 –58.

Pandey, I.M. (2005). *Financial Management (10th Ed)*. New Delphi, India, Vikas Publishing

Soini, E., & Veseli, I. (2011). *Factors Influencing SMEs Growth in Kosovo*

Wanjiku, L. K. (2013). *The Effect of Working Capital Management Practices on the Financial Performance of Small and Medium Enterprises in Kenya*. A masters research project.