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Abstract: Small and Medium enterprises (SMEs) make important contributions to economic and social development of any country. The aim of this study was to determine the extent of financial management practices employed by the SME’s and their effect on growth. The specific objectives of this study were to determine the effect of working capital management practices, investment practices, financial planning practices, accounting information systems, financial reporting and analysis practices on the growth of SME. Nairobi County records indicate there are over 50,000 small and micro enterprises in the County. Kenya Association of Manufacturing through the baseline study of 1999, (KAM 2009) recorded 745 active manufacturing SME’s in Kenya with a population of 410 in Nairobi County. Primary data was collected from 41 SMEs using a questionnaire administered to the business owner/manager of the SMEs. A simple random sampling technique was used to select the SMEs. Descriptive and inferential statistics were used to analyze the data. The study established that 75% of the SMEs sold their products cash while 82% maintained a cash limit, 92% have a manual inventory register; 35% have invested in long term assets while 45% used internally generated funds for business financing. 55% do not have a formal accounting system and 74% prepared financial statements without a qualified accountant. The Ministry of Industrialization should introduce capacity building programs for SMEs in the issues of financial management practices.

Keywords: Small and medium enterprises (SME’s), Financial Management Practices, Nairobi County

I. Introduction

Small and medium enterprises (SMEs) make important contributions to economic and social development of any country. According to ILO (2008) about 80% of the labour force in Japan and 50% of workers in Germany are employed in the SME sector. With respect to developing countries, the SMEs made a significant contribution to the gross domestic product of Uganda (20%), Kenya (19.5%) and Nigeria (24.5%). As in most developing countries, small and medium-scale enterprises form a significant part of the economic growth. Nevertheless, they face a number of problems, including access to finance from formal sources, which is often considered to be the most important problem (MFPED, 2008). Consequently, the growth of the SME sector directly affects the performance of the nation. In all economies they constitute the vast majority of business establishments and they are usually responsible for the majority of employment opportunities created which account for one third to two thirds of the private sector turnover (Ntsika, 2002). It is estimated that SMEs contribute 56% of private sector employment and 36% of the Gross Domestic Product (GDP) worldwide (Arianoff, 2010). In many countries, SMEs have been a major engine of growth in employment and output over decades. In developing countries they are seen as a major ‘self-help’ instrument for poverty eradication due to the ease of entry and exit.

Small and Medium Enterprises (SMEs) contribute greatly to the economies of all countries, regardless of their level of development. The term SMEs covers a wide range of perceptions and measures, varying from country to country and between the sources reporting SME statistics. Some of the commonly used criterions are the number of employees, total net assets, sales and investment level. However, the most common definition used is based on employment, but, there is a variation in defining the upper and lower size limit of an SME (Ayyagari, Beck & Demirguc-Kunt, 2006). According to Hatten (2008) the term SME (Small and Medium Enterprises) is used in the European Union and other international organizations to designate companies that have a limited, specified number of employees, while the United States typically uses the term "SMB" (Small to Medium Business) instead. Classification as an SME is based on the number of employees, generally between 10 and 100, depending on the country in which the business is set up (Norlaphoompipat, 2008).

In Kenya, a micro-enterprise is defined as having no more than 10 employees; a small enterprise with 11-50 employees; and a medium/large enterprise with more than 50 employees, as indicated by National Micro and Small Enterprise Baseline Survey (1999). According to the IMF (2001) report on Poverty Reduction Strategy in Kenya, the potential of small medium enterprises in both employment creation and generation of incomes for many Kenyan families makes them a key element in the poverty reduction strategy. The small
business enterprises play an important role in the Kenyan economy. According to the Economic survey report, (2006) the sector contributed over 50 per cent of new jobs created in the year 2005. Recent evidence shows that Small and Medium Enterprises (SMEs) form the bulk of Kenya private sector. If Kenya is to become competitive through growth of the private sector, it is inevitable that more attention must be paid to addressing the key bottlenecks to SME growth and competitiveness (KNBS, 2007). Good financial management practices have been viewed as critical elements in the success of SMEs in developing countries. Though SMEs are making positive contributions to economic growth and development in Kenya, the rate of failure is high. According to KNBS (2007), the SME sector generated 469,000 new jobs in 2006-2007 financial years, which was an increase of 5.7% from the previous year. Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007). Owing to their importance to the Kenyan economy, there was need to conduct a study to investigate financial management practices by the SME’s and how these affect the business growth. 

Financial management is one of several functional areas of management which is central to the success of any small business (Meredith, 2006). Financial management is the management of finances of a business in order to achieve the financial objectives of the business. McMahon et al. (2008) defines financial management based on mobilizing and using sources of funds: Financial management is concerned with raising the funds needed to finance the enterprise’s assets and activities, the allocation of these scare funds between competing uses, and with ensuring that the funds are used effectively and efficiently in achieving the enterprise’s goal.

Financial management as used in this study is composed of five (5) constructs and these include; working capital management which is also subdivided into cash management, receivables management and inventory management. Other constructs under financial management include; investment, financing, accounting information systems and financial reporting and analysis. Ross et al (2009) indicated three kinds of decisions the financial manager of a firm must make in business; these include the financing decision, and decisions involving short-term finance and concerned with the net working capital, investment and financial reporting. Similarly, Ang (2002) indicated three main financial decisions including the investment decisions, financing decisions and dividend decisions. Meredith (2006) asserts that financial management is concerned with all areas of management, which involve finance not only the sources, and uses of finance in the enterprises but also the financial implications of investment, production, marketing or personnel decisions and the total performance of the enterprise. However, such areas are not currently well embraced by SMEs in Kenya and urgent attention needs to be paid to. Lack of effective management during SMEs early stages is also a major cause of business failure for small businesses. Owners tend to manage these businesses themselves as a measure of reducing operational costs.

Inefficient financial management may damage business efficiency and this will continuously affect the growth of the Small and Medium enterprises. However, efficient financial management is likely to help SMEs to strengthen their business efficiency and, as a result, these difficulties can partly be overcome. Kazooba (2006) argues that though Kenya is among the countries with high start up of SMEs, it also has the highest numbers of non performing SMEs as well high number of closure of SMEs. However, the studies conducted did not show how the components of financial management affect the overall business efficiency of SMEs. A large number of business failures have been attributed to inability of financial managers to plan and control properly the current assets and current liabilities of their respective firms (Mbaga, 2002).

Research Problem

According to the IMF (2001) report on Poverty Reduction Strategy in Kenya, the potential of small medium enterprises in both employment creation and generation of incomes for many Kenyan families makes them a key element in the poverty reduction strategy. The small business enterprises play an important role in the Kenyan economy. According to the Economic survey report, (2006) the sector contributed over 50 per cent of new jobs created in the year 2005. According to KNBS (2007), the SME sector generated 469,000 new jobs in 2006-2007 financial years, which was an increase of 5.7% from the previous year.

According to Wanjohi (2009) starting and operating a small business includes a possibility of success as well as failure. Because of their small size, a simple management mistake is likely to lead to sure death of a small enterprise hence no opportunity to learn from its past mistakes. This may be attributed to lack of planning, improper financing and poor management has been cited as the main causes of failure of small enterprises (Longenecker, 2006). Though it is clear that SMEs play a critical role in economic development the rate in which newly established SMEs collapsing is wanting. It is against this realization that the current study aims to investigate the effect of financial management practices on growth of SMES.
Research Objective
Main Objective
The aim of this study was to determine the extent of financial management practices employed by the SME’s and their effect on growth.

Specific Objectives
The specific objectives of this study were:

i. To determine effect of working capital management practices on the growth of SMEs in Kenya.
ii. To establish influence of investment practices on the growth of SMEs in Kenya.
iii. To examine how financial planning practices influence on the growth of SMEs in Kenya.
iv. To determine the influence of accounting information systems on the growth of SMEs in Kenya.
v. To scrutinize the effect of financial reporting and analysis practices on the growth of SMEs in Kenya.

Hypotheses
H₁: Working capital management practices influence the growth of SMEs in Kenya.
H₂: Investment practices influence the growth of SMEs in Kenya.
H₃: Financial planning practices influence the growth of SMEs in Kenya.
H₄: Financial reporting and analysis practices influence the growth of SMEs in Kenya.

Theoretical Framework
The study is based on the Pecking Order Theory. Pecking order theory of capital structure states that firms have a preferred hierarchy for financing decisions. The highest preference is to use internal financing (retained earnings and the effects of depreciation) before resorting to any form of external funds. Internal funds incur no flotation costs and require no additional disclosure of proprietary financial information that could lead to more severe market discipline and a possible loss of competitive advantage. If a firm must use external funds, the preference is to use the following order of financing sources: debt, convertible securities, preferred stock, and common stock. (Myers, 1984) This order reflects the motivations of the financial manager to retain control of the firm (since only common stock has a “voice” in management), reduce the agency costs of equity, and avoid the seemingly inevitable negative market reaction to an announcement of a new equity issue. (Hawawini and Viallet, 1999)

Implicit in pecking order theory are two key assumptions about financial managers. The first of these is asymmetric information, or the likelihood that a firm’s managers know more about the company’s current earnings and future growth opportunities than do outside investors. There is a strong desire to keep such information proprietary. The use of internal funds precludes managers from having to make public disclosures about the company’s investment opportunities and potential profits to be realized from investing in them. The second assumption is that managers will act in the best interests of the company’s existing shareholders. The managers may even forgo a positive NPV project if it would require the issue of new equity, since this would give much of the project’s value to new shareholders at the expense of the old. (Myers and Majluf, 1984).

Pecking order theory is important for explaining capital structure changes. By including a discussion of pecking order theory in the capital structure unit financial managers are exposed to a broad base of both theory and practice that will enable them to better understand how important financing decisions are made. In addition to the traditional discussion of the impact of taxes, financial distress, and agency costs upon capital structure decisions, Pecking order theory help financial managers to gain insight to how management motivations and market perceptions also impact these decisions. Furthermore, the addition of pecking order theory into the basic discussion of capital structure provides one more opportunity for critical thinking to occur. For example, a financial manager can show how the debt ratios of leading companies in particular industries differ from the industry averages to which most companies are usually compared during a cross-sectional financial analysis.

II. Literature Review

Working Capital Management
Previous researchers emphasized specific aspects of working capital management. Burns and Walker (2001) examined working capital management as a whole. In their survey of working capital policy among small manufacturing firms in the USA, the following aspects of working capital were considered: working capital policy, managing working capital components, including cash, receivable, payable and inventory management, and relationships between working capital management practices and profitability without clearly handling other aspects of business efficiency.

Wanjohi (2009) conducted a study to elucidate the working capital practices of SMEs in Kenya using a sample of 113 SMEs. They concluded that working capital practices are low amongst SMEs as majority had not adopted formal working capital routines. Agyei-Mensah (2010) also conducted a research into the
working capital practices of SMEs in the Ashanti region of Ghana. Using a sample of 800 randomly selected firms the study revealed weak working skills within the sector. Despite the importance of working capital management to SMEs, a research by Burns and Walker (1991) and Peel and Wilson (1994) show that only 24 per cent and 20 per cent respectively of the financial manager's time is spent on working capital. Harif et al. (2010) did a research on the financial management practices of SMEs in Malaysia, with the results indicating that lack of working capital which accounted for 93.6 per cent is the most common weakness in the area of financial management.

Cash management practices among SMEs were found to be inadequate in the study done by Grablowsky (2008). Grablowsky and Lowell (2008) conducted a questionnaire survey concerned with the cash management practices of 66 small enterprises from a number of industries located in and around Norfolk, Virginia. The results showed that 67 percent of respondents replied they did not do forecasting of cash flows. When asked how they determined the level of cash to be held by the business, less than 10 percent of enterprises reported using any type of quantitative technique. Additionally, seventy-one percent of business in the Virginia survey reported that they had no short-term surpluses of cash in their recent history. Only 23 percent had a long-term surplus. Nearly 30 percent of respondents had invested excess cash in earnings securities or accounts. The most common investments were savings accounts, certificates of deposit, treasury bills, repurchase agreements, commercial papers, shares, bonds and other investments.

In the study conducted by Cooley and Pullen (1979), cash management was seen as the process of planning and controlling cash flows. It consisted of three basic components: cash forecasting practices, cash surplus investment practices and cash control practices. Cooley and Pullen (1979) examined cash management practices of 122 small businesses engaged in petroleum marketing and reported that 73 percent of respondents had experienced a cash surplus. In a divergent view to Grablowsky and Rowell's (1978) and Cooley and Pullen's (1979) survey, Murphy's (1979) study indicated that active cash management in small enterprises in the UK was unusual, and that there was little inclination to invest surplus cash on a short-term basis.

Regarding accounts receivable management practices, Grablowsky (1976) and Rablowsky and Lowell (1980) found generally low standards. Approximately 95 percent of businesses that sold on credit tended to sell to anyone who wished to buy. Only 30 percent of respondents subscribed to a regular credit reporting service. Most had no credit checking procedures and guidelines, and only 52 percent enforced a late-payment charge. Thirty-four percent of businesses had no formal procedure for aging accounts receivable. Bad debts averaged 1.75 percent of sales, with a high of 10 percent in some concerns. Murphy (1978) revealed a very high level of awareness and utilization of credit control systems in the UK, even in the smallest businesses.

The previous studies done on inventory management practices, D'Amboise and Gasse (1980) studied the utilization of management techniques in small shoe and plastic manufacturing industries in Canada and found 64 percent of shoe and 65.4 percent of plastic businesses employed formal inventory control systems. While Grablowsky and Rowell (1980) found that most of the respondents had in excess of 30 percent of their capital invested in inventory, the general standard of inventory management was poor. Only six percent of businesses in their survey used a quantitative technique such as economic order quantity for optimizing inventory and 54 percent had systems which were unable to provide information on inventory turnover, reorder points, ordering costs or carrying costs. Related to the methods used to determine inventory level, Grablowsky (1984) compared methods used by a sample of 94 small enterprises with those used by large enterprises and found that large enterprises used methods to determine inventory levels far more than small enterprises.

**Investment**

Brigham (1995) suggested that capital budgeting might be more important to a smaller firm than its larger counterparts because of the lack of access to the public markets for funding. Capital budgeting has attracted researchers over the past several decades. McMahon et al. (1993) claimed the earliest study of capital budgeting of SMEs was reported by Soldofsky (1964). During 1961, Soldofsky interviewed 126 owners of small manufacturing businesses in Iowa and the results were published in 1964. Regarding capital project selection techniques, there were several surveys conducted by previous researchers such as Soldofsky (1964), Luoma (1967), Taylor Nelson Investment Services (1970), Hankinson (1979), Grablowsky and Burns (1980), Proctor and Canada (1992), and Block (1997). Soldofsky's (1964) study results shows around 58 percent of respondents used payback period methods whereas only 4.1 percent employed accounting rate of return technique.

Block's (1997) survey of 232 small businesses in the USA indicated payback method remains the dominant method of investment selection for small businesses, whereas large corporations widely incorporate discounted cash flow models in financial analysis of capital investment proposals (Proctor and Canada, 1992). This is not evidence of a lack of sophistication as much as it is a reflection of financial pressures put on the small business owner by financial institutions. Payback period was used to evaluate capital projects by 51 percent of respondents, while 30 percent reported use of some variation of accounting rate of return. Only 10 percent reported use of discount cash flow methods such as net present value (5 percent) and internal rate of
Financing

Small companies frequently suffer from a particular financial problem of lack of a capital base. Small businesses are usually managed by their owners and available capital is limited to access to equity markets, and in the early stages of their existence owners find it difficult in building up revenue reserves if the owner-managers are to survive. A question concerns how small businesses determine sources of finance in such difficult circumstance. According to Brigham (1995), modern capital structure theory began in 1958, when Modigliani and Miller’s (1958) seminal article on capital structure was published. Since that point of time, researchers have attempted to explain how firms choose their capital structure. Myers (1984) stated: How do firms choose their capital structure? The answer is we don’t know…we do not know how firms choose the debt, equity, or hybrid securities they issue. This study was based on capital structure theory and Myers’ Pecking Order Theory (1984). According to Myers (2004), the Pecking Order Theory (POT) suggests that there is no well-defined optimal capital structure; instead the debt ratio is the result of hierarchical financing over time. The foundation of POT is that firms have no defined debt-to-value ratio. Management has a preference to choose internal financing before external financing.

When a firm is forced to use external financing sources, managers select the least risky and demanding source first. When it is necessary to issue external sources, debt issuance is preferred to new equity. In an attempt to explain small firm financing behavior, other scholars have relied on agency theory. Agency theory holds that investors who have equity or debt in a firm require costs to monitor the investment of their funds by management or the small business owner (agency costs). This view suggests that financing is based on the owner-manager being able to assess these agency costs for each type of financing, and then select the lowest cost method of financing the firm’s activities. One weakness of this explanation is that no one has yet been able to measure agency costs, even in large firms (Myers, 2004). Barton and Gordon (1988) suggest that the following characteristics must be accounted for in any explanation of firm financing decisions: behavior at the firm level; fact that the capital structure decision is made in an open systems context by top management, and decisions reflects multiple objectives and environmental factors, not all of which are financial in nature. The firm’s financing decision, then, appears to be a product of many internal and external factors, as well as managerial values and goals.

Thevaruban (2009) examined small scale industries and its financial problems in Sri Lanka. He underscored that SMEs of small scale industries in Sri Lanka finds it extremely difficult to get outside credit because the cash inflow and savings of the SMEs in the small scale sector is significantly low (Ganesan, 1982; 2000). Hence, bank and non bank financial institutions do not emphasise much on credit lending for the development of the SMEs in the small scale sector in Sri Lanka. Pettit and Singer (1985) study underscored that financing is the most difficult problems of the SMEs in USA. External finance is more expensive than internal finance (Watson et al., 1998; Datta, 2010). Due to lack of access to external finance (private placements and initial public offerings of varying sizes), SMEs rely on bank loans as compared to their larger counterparts (Bracker et al., 2006).

Ssendaula (2002) lists factors that have discouraged banks from lending to SMEs. Among them are poorly compiled records and accounts; low levels of technical and management skills; outdated technologies; lack of professionalism and networking; lack of collateral; lack of market outlets due to poor quality and non-standardized products; poor linkages and limited knowledge of business opportunities. In addition, most businesses, such as those dealing in foodstuffs, have been affected by lack of proper storage facilities. This has been a major limitation on business success because most agricultural products require preservation and have an inelastic demand meaning that even if their prices are lowered, quantity demanded can increase in that same proportion to clear the market of surpluses.

Accounting Information Systems

D’Amboise and Gasse (1980) studied the utilization of formal management techniques in 25 small shoe manufacturers and 26 small plastic manufacturers in Quebec, Canada and found that 88 percent of the businesses used a cost accounting system. Regarding accounting standards, DeThomas and Fredenberger (1985), in a survey of over 360 small enterprises in Georgia, found that the standard of financial record keeping was very high. In addition to cheque and deposit receipts, around 92 percent of respondents had some form of record keeping. Regarding the use of financial information, DeThomas and Fredenberger’s (1985) study indicated that 96 percent of the respondents had financial statements prepared, the responsibility for evaluating and using the information was within the business itself and only four percent relied on an outside accountant services.
In the survey of 69 small enterprises across the USA, Farhoodman and Hryck (1985) reported on the most important applications of computers, and it was found out that accounting was rated as the highest percentage. Similarly, Palmer (1994) interviewed 36 small independent retail owner-managers and found that 33 percent of the sample businesses used computerized accounting systems. Reviewing previous research results shows accounting and financial management applications dominated the use of computers in small and medium enterprises in the North America in 1980’s and 1990’s.

Williams (1986) evaluated the adequacy of accounting records for 10,570 failed and surviving small enterprises operating throughout Australia. The findings are compatible with Peacock’s (1986, 1987 and 1988) findings in that a significant proportion of owner-managers kept inadequate accounting records. Holmes (1987) conducted a survey of accounting information requirements of 928 small enterprises operating in Sydney, Melbourne and Brisbane. Fifty-seven percent of respondents indicated they used the journal/ledger (double entry) systems. This finding is rather in contrast to Peacock’s (1987) findings of types of records maintained by failed enterprises, where only 2.1 percent of respondents were found to use double entry systems.

Financial reporting and analysis

Bookkeeping alone without preparing reports is likely not to be fundamental in aiding decision making unless proper reports are prepared and analyzed to attach a meaning so as to help decision makers. D’Amboise and Gasse (1980) studied the use of financial statement analysis by small manufacturers in Quebec, Canada and found that small manufacturers in shoe and plastic industries formally undertook the analyses based on financial statements and the findings revealed that manufacturing firms managerial decisions were largely based on the financial reports prepared.

The research conducted by DeThomas and Fredenberger (1985) found that 81 percent of the small enterprises regularly obtained summary financial information. Ninety-one percent of the summary information was in the form of traditional financial statements (balance sheets, profit and loss statements, fund statements), the remainder being bank reconciliation and operating summaries whereas no business was regularly receiving cash-flow information. The study further found that 61 percent of respondents felt the financial statements provided the information they required for planning and decision-making. Nevertheless, only 11 percent of respondents reported that they had used financial statement information formally as part of managerial evaluation, planning and decision making, 2 percent of businesses utilized financial ratio analysis, and few made even simple historical comparisons.

Thomas and Evanson (1987) studied 398 small pharmacies (in Michigan, North Carolina, Nebraska, Rhode Island and Washington) to examine the extent to which financial ratios were used in a specific line of small retail business and tested for a relationship between use of financial ratios and business success. The study used regression analysis to examine the relationship between financial ratio usage and SMEs profitability. However, they could not demonstrate any significant relationship between earnings-to-sales and the number of financial ratios used by the owner in operational decision-making. When efforts were made to include the effects of other managerial practices and variations in business environments, no association between use of individual ratios and total earnings or total to sales was found.

Conceptual Framework

Mugenda (2008) defines conceptual framework as a concise description of the phenomenon under study accompanied by a graphical or visual depiction of the major variables of the study. According to Young (2009) conceptual framework is a diagrammatical representation that shows the relationship between dependent variable and independent variables. In the study, the conceptual framework will look at the relationship between financial management practices employed by the SME’s and their effect on growth. The dependent variable is growth of SMEs while independent variables are working capital management practices, investment practices, financial planning practices, accounting information systems and financial reporting and analysis.
Research Design
This study used a descriptive research design. A descriptive research design attempts to describe or define a subject, often by creating a profile of a group of problems, people, or events, through the collection of data and tabulation of the frequencies on research variables or their interaction, (Cooper & Schindler, 2006). It is concerned with describing the characteristics of a particular individual, or of a group. In this case, the research problem was to investigate the effect of financial management practices on growth of small and medium enterprises with focus to service enterprises in Nairobi County, Kenya. A descriptive research defines questions, people surveyed, and the method of analysis prior to beginning data collection. Thus, this approach is appropriate for this study, since the researcher intended to collect detailed information through descriptions and is useful for identifying variables and hypothetical constructs.

Population
According to KAM (2009), there were 745 active manufacturing SMEs in Kenya. Mugenda and Mugenda (2003) state that the target population should have some observable characteristics, to which the researcher intends to generalize the results of the study.

Sample Population
The study used simple random sampling technique in coming up with the sample of the study. Simple random sampling technique is used as it minimizes sampling error as each element in the target population is accorded equal (unbiased) probability of being selected. Using probabilistic sampling each population member has a known chance of being included in the sample. Statistically, in order for generalization to take place, a sample of at least 30 must exist (Cooper and Schindler, 2003). Moreover, larger sample minimize errors. Kotler (2001) argues that if well chosen, samples of about 10% of a population can often give good reliability. Other literatures have shown that sample size selection to a great extent is judgmentally decided. The study selected a sample of 10% manufacturing SMEs in Nairobi County contributing to 41 SMEs.

Data Collection
The study collected primary data for the purpose of investigating the effect of financial management practices on growth of small and medium enterprises. Primary data was collected using a questionnaire. The questionnaire had both open and close-ended questions. The close-ended questions provided more structured responses to facilitate tangible recommendations. The closed-ended questions were used to test the rating of various attributes and this helped in reducing the number of related responses in order to obtain more varied responses. The open-ended questions provided additional information that might not have been captured in the close-ended questions.

Figure 5.1: Effect of Financial Management Practices on SME’s Growth
Majority (62%) of the respondents were males while females constituted 38%. Since the sample was drawn at random, it can be concluded that there were more male SMEs owners compared to female SMEs owners.

Majority of the respondents at 36% were aged between 29 and 38 years followed by 30% aged between 39 and 48 years. Then 20% of the respondents were within the age of 18 to 28 years and 14% of the respondents were above 50 years. This implies that majority of SMEs owners are youthful.

Diploma education was the most common at 40%, followed by university level education at 34%, then postgraduate level at 20%. The least was secondary education at 6%. We can make the general conclusion that a large percentage of the respondents were well educated and as a result, the majority of the respondents would be able to engage in financial management practices.

Majority of the respondents at 45% had a working experience of above 5 years. Followed by 38% who had a working experience of 3 to 4 years and 17% of the respondents had a working experience of 1 to 2 years. This implies that majority of the respondents have a good experience on financial management practices in SMEs.

The study finding in Table 2 shows that majority of the businesses were Sole proprietorship (38%) while 36% were limited liability companies, 14% partnerships and 12% family businesses. This indicates that majority of SMEs were sole proprietorships.

The respondents were requested to give information on the number of years the business has been in operation. Majority (48%) of the businesses had been in operation for 5 years and above, 32% of the respondents had been in operation for 3 to 5 years and 20% for 1 to 3 years. This indicates that majority of the SMEs have operated for more than five years hence they have an experience on financial management practices.

Majority of the SMEs at 58% had 1 to 2 branches, 32% had 3 to 4 branches and 10% had 5 and above branches. 57% of the SMEs customers are individuals, 29% are organization and 14% are institutions.

The study established the Growth of SMEs in Nairobi in terms of average sales per year and the number of employees per year for a three year period 2011-2013. Table 3 shows the findings of the study.
The study findings in Table 5 show that the sales of the SMEs have been increasing in the three year period: KSh. 30 million in 2011, KSh. 37 million in 2012 and KSh. 43 million in 2013. Similarly, the number of employees increased in the three year period: 21 in 2011, 25 in 2012 and 32 in 2013. This implies that the SMEs have engaged in good financial management practices hence the increment in sales and number of employees.

Results and Discussion on the Study Objectives

Cash management

Majority (94%) of the respondents had a bank account. Many (75%) of the respondents held accounts in commercial banks while 12%, 9% and 4% held accounts in micro finance institutions, SACCOs and mobile phones respectively. The accounts are mainly current accounts (68%), group account (45%) and savings account (36%).

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<th>Table 4: Cash management</th>
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<td>Does the business sell services/goods by cash?</td>
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<td>Does the business give cash receipts to customers?</td>
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<td>Does the business make cash flow projections?</td>
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<td>Does the business carry out daily cash reconciliation?</td>
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<td>Does the business maintain a cash operating limit?</td>
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<td>Does the business have a full time cashier?</td>
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The study established that 75% of the business sell services/goods by cash, 62% give cash receipts to customers, 66% make cash flow projections (Table 3). The study further established that 74% of the businesses carry out daily cash reconciliation, 82% maintain a cash operating limit and 60% have a full time cashier as indicated in table 4.

Accounts receivable management

The study established that majority (85%) of the businesses do not sell goods/services on credit. The 15% of the businesses that sell goods/services on credit mainly do so for a period of 30 days. The study established that majority of the businesses (58%) do not prepare an aging schedule. Only 15% of the businesses have a credit policy while 72% of the businesses use computer assisted software in managing receivables as shown in table 5.

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<th>Table 5: Accounts receivable management</th>
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<td>Does the business sell services/goods by credit?</td>
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<td>Does the business use computer assisted software in managing receivables?</td>
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Inventory management

The study established that majority (95%) of the businesses have an inventory register, prepare periodic summaries of inventory usage and carry out periodic inventory counts. However, only 35% of the businesses have physical safeguard of inventory against theft and 25% use computer assisted software in managing inventory as indicated in table 6.

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<td>Is there an inventory register?</td>
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<td>Does the business have physical safeguard of inventory against theft?</td>
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<td>Does the business use computer assisted software in managing inventory?</td>
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The study findings indicate that not all SMEs within Nairobi have adopted cash management practices. According to Wanjohi (2009) failure to adopt cash management practices hinders business growth which eventually leads to their failure. Similarly research in the United States reported that internal problems related to cash flow management and inadequate capital (Dodge et al, 1994) led to higher failure of SMEs.

Investment practices on the growth of SMEs in Kenya.

The study established that majority (65%) of the businesses have not invested in long term assets while 35% have invested in long term assets. 18% of the businesses have long term investment in buildings followed by land (10%) and machinery (7%).

The study found out that 65% of the businesses have also invested in short term assets. The main type of short term investment is cash deposit (35%) followed by stock (15%), bonds (10%) and treasury bills (5%).

The respondents were asked whether the business seek professional advice before investing. Majority (78%) of the respondents indicated that they do not seek professional advice before any business investment. The respondents indicated that only 44% of the businesses evaluate investments after a certain period. Majority (65%) of the business carry out annually evaluation and 25% carry out semiannual evaluations and 10% do quarterly evaluations.

<table>
<thead>
<tr>
<th>Table 7: Investment</th>
<th>Yes (%)</th>
<th>No (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Has the business invested in long term assets?</td>
<td>35</td>
<td>65</td>
</tr>
<tr>
<td>Has the business invested in short term assets?</td>
<td>65</td>
<td>35</td>
</tr>
<tr>
<td>Does the business seek professional advice before investing?</td>
<td>22</td>
<td>78</td>
</tr>
<tr>
<td>Does the business evaluate its investments after a certain period?</td>
<td>44</td>
<td>56</td>
</tr>
</tbody>
</table>

The study findings revealed that many SMEs do not invested in long term assets. The findings imply that the utilization of non-current assets is not effectively managed by SMEs in Nairobi. This has a big effect on the overall profitability of the businesses. Though some of the SMEs may have cash for investment, the majority of them invests without evaluating the investments. This puts the initial amount invested at stake as some of the businesses may not be viable. Louma (1967) conducted a survey of small and medium-sized manufacturing businesses in the United States and found that more than 22 percent of SMEs used formal methods of capital investment evaluation but none of them used NPV. This means that if the investment goes bad on the way there is no way to know how to bring it back on track and thus losing the initial investment. Similarly few of the SMEs invest in real estate and at the stock exchange. This clearly shows that the nearly convertible investments are not priority for investments for SMEs as earlier researches like Nkungi (2008) stated that most of the SMEs failed to identify investment opportunity hence poor financial performance.

Financial planning practices influence on the growth of SMEs in Kenya.

The study established that 45% of the businesses use internally generated funds only, 25% use borrowed funds only and 30% use both internally generated funds and borrowed funds. The other sources of fund for businesses are informal lenders (55%), credit suppliers (30%) and family funds (15%).

<table>
<thead>
<tr>
<th>Table 9: Financing</th>
<th>Yes (%)</th>
<th>No (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internally generated cash source</td>
<td>45</td>
<td>55</td>
</tr>
<tr>
<td>Borrowed funds only</td>
<td>25</td>
<td>75</td>
</tr>
<tr>
<td>Internally generated cash and borrowed funds</td>
<td>30</td>
<td>70</td>
</tr>
</tbody>
</table>

The study revealed that most of the SMEs use internally generated funds. The access to bank loans by SMEs is low due to factors such as lack of collateral security, high costs associated with interest rates, fear of the bureaucratic tendencies that must be followed by the banks in order to access bank loans and poor record keeping. A similar study by Kazooba (2006) also found out that most of SMEs use internally generated funds and experience challenges in accessing finances which contributed much to business failure. Currie (2009) found out that the majority of SMEs in countries such as Ethiopia operate at under capacity due to lack of credit or over-regulation. This problem has been exacerbated by the demand for collateral by commercial banks as a prerequisite for the approval of loan applications. Aguirreaga biria (2007) and Buldyrev (2007) argue that collateral is needed mostly due to the significant information gap that exists between potential lenders and borrowers. According to Wanjohi (2009) clear financial planning gives room for SMEs growth though only few of the SMEs practice this resulting to poor financial performance. The study findings also support the Theory of Pecking Order as suggested by Myers (1984) which states that Management has a preference to choose internal financing before external financing.

Accounting information systems on the growth of SMEs in Kenya.
The study established that majority (55%) of the businesses do not have a formal accounting system and lack an operating accounting department. 62% of the businesses do not have an accountant in charge of recording all transactions. Many of the businesses (72%) do not use computer assisted software in recording transactions.

The study revealed that most of the businesses do not have a formal accounting system, lack an operating accounting department, do not have an accountant in charge of recording all transactions and do not use computer assisted software in recording transactions. This is probably due to the fact that most of the SMEs are owned by sole traders who end up doing all the work themselves. The findings further revealed that most of the SMEs accounting systems are informal. Some of the SMEs may fear to maintain formal systems because they come with maintenance costs.

The findings showed that the accounts departments are not functional and not efficiently operated which hinders financial reporting. Few of the SMEs employ accountants and put them in charge of recording transactions due to limited resources to enable SMES afford the services of professional accountants. Failure to use computers and computer assisted software among SMEs makes timely financial reporting as well as decision making very difficult. The study findings are in agreement with the previous studies Peacock (1988) who revealed that few of the SMEs in South Africa were fully utilizing accounting information systems and that contributed to their failure. KAM (2009) argued that adoption of Technology advancement in business financial management enhances organization performance.

### Financial reporting and analysis practices on the growth of SMEs in Kenya

The study established that 74% of the businesses prepare financial statements but only 46% of the business engaged the services of a qualified accountant and 24% of the businesses engage the services of external auditors in preparing the financial statements. In 85% of the businesses, the owner/manager is involved in preparing the financial statements. The study found out that 66% of the businesses prepare financial statements on a quarterly basis while 25% and 9% prepare financial statements on a semi-annual and annual basis respectively.

<table>
<thead>
<tr>
<th>Table 10: Accounting Information System</th>
<th>Yes (%)</th>
<th>No (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the business have a formal accounting system?</td>
<td>45</td>
<td>55</td>
</tr>
<tr>
<td>Is the accountant in charge of recording all transactions?</td>
<td>38</td>
<td>62</td>
</tr>
<tr>
<td>Is there an operating accounting department?</td>
<td>45</td>
<td>55</td>
</tr>
<tr>
<td>Does the business use computer assisted software in recording transactions?</td>
<td>28</td>
<td>72</td>
</tr>
</tbody>
</table>

The respondents also stated that small businesses fail because of limited vision, lack of financial planning and review, poor market segmentation and strategy, poor knowledge of competition among others yet small business units provide opportunity for higher employment, lower cost, easy entry and more equitable distribution of national income than the organized sector.

### Hypothesis testing

**Test of Association between financial management practices and the growth of SMEs in Kenya.**

Chi-square test

Chi-Square Test was used to test the null hypotheses of the study. The table 11 below contains the chi-square score for the table (labeled Pearson chi-square), the table's degrees of freedom, and the p-value associated with the obtained chi-square score.

<table>
<thead>
<tr>
<th>Table 11: Chi-Square Test of independence financial management practices versus growth of SMEs in Kenya.</th>
<th>Pearson Chi-Square Value</th>
<th>Df</th>
<th>Asymp. Sig. (2-sided)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working capital management practices Vs growth of SMEs in Kenya.</td>
<td>8.215</td>
<td>3</td>
<td>0.031</td>
</tr>
<tr>
<td>Investment practices Vs growth of SMEs in Kenya.</td>
<td>8.114</td>
<td>3</td>
<td>0.002</td>
</tr>
<tr>
<td>Financial planning practices Vs the growth of SMEs in Kenya.</td>
<td>8.135</td>
<td>3</td>
<td>0.011</td>
</tr>
<tr>
<td>Accounting information systems Vs the growth of SMEs in Kenya.</td>
<td>8.205</td>
<td>3</td>
<td>0.029</td>
</tr>
<tr>
<td>Financial reporting and analysis practices Vs the growth of SMEs in Kenya.</td>
<td>8.208</td>
<td>3</td>
<td>0.014</td>
</tr>
</tbody>
</table>

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The overall relationship between working capital management practices and the growth of SMEs in Kenya was statistically significant ($\chi^2=8.215$, df =3, p=0.031).

Investment practices had a statistically significant relationship with the growth of SMEs in Kenya at a given level of significance ($\chi^2=8.114$, df =3, p=0.002).

Financial planning practices demonstrates a statistically significant relationship with the Growth of SMEs in Kenya ($\chi^2=8.135$, df =3, p=0.011).

The relationship between Accounting information systems and the growth of SMEs in Kenya was statistically significant ($\chi^2=8.205$, df =3, p=0.029).

Financial reporting and analysis practices had a significant relationship with the growth of SMEs in Kenya ($\chi^2=8.204$, df =3, p=0.014).

Therefore, the study failed to reject all the null hypotheses leading to the conclusion that growth of SMEs in Kenya is influenced by working capital management practices, investment practices, financial planning practices, accounting information systems and financial reporting and analysis practices.

**Correlation**

The Pearson product-moment correlation coefficient was used to analyses the association between the independent and the dependent variables. The Pearson correlation coefficients above 0.5 in the matrix indicated great correlation between the dependent variable (Growth of SMEs) and the independent variables (working capital management practices, investment practices, financial planning practices, accounting information systems and financial reporting and analysis practices).

**Table 12: Pearson Correlation coefficients**

<table>
<thead>
<tr>
<th></th>
<th>Growth of SMEs</th>
<th>Working capital management</th>
<th>Investment</th>
<th>Financial planning</th>
<th>Accounting information systems</th>
<th>Financial reporting and analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth of SMEs</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working capital management</td>
<td>0.812</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>0.655</td>
<td>0.168</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial planning</td>
<td>0.621</td>
<td>0.124</td>
<td>0.135</td>
<td>1.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounting information systems</td>
<td>0.513</td>
<td>0.116</td>
<td>0.154</td>
<td>0.24</td>
<td>1.000</td>
<td></td>
</tr>
<tr>
<td>Financial reporting and analysis</td>
<td>0.638</td>
<td>0.261</td>
<td>0.217</td>
<td>0.162</td>
<td>0.178</td>
<td>1.000</td>
</tr>
</tbody>
</table>

Working capital management had the highest positive correlation coefficient with growth of SMEs at 0.812, followed by financial reporting and analysis at 0.638, then investment practices at 0.655. This was followed by financial planning at 0.621 and lastly accounting systems at 0.513.

**IV. Conclusion and Recommendation**

The study concludes that financial management practices (working capital management practices, investment practices, financial planning practices, accounting information systems and financial reporting and analysis practices) are major determinants of the growth of SMEs in Kenya. The small and micro enterprises (SME) play an important role in Kenyan Economy. Inefficiencies in financial management result in poor financial performance and eventually lead to failure of SMEs. A high rate failure of failure of SMEs has adverse effects on the economy hence the need for sound financial management practices among Kenyan SMEs. The adoption of financial management practices provide opportunities for the business enterprise to respond to the various challenges within its operating environment. Thus SMEs should embrace strong financial management systems.

Innovation is key to the growth of SMEs and effort should be made to ensure SMEs are in vanguard of innovation for them to be competitive through enhancement of financial management practices through ICT. The ever changing needs of customers once met will enhance customer retention and sustainable growth rate. SMEs should also be encouraged to partner due to the high involvement in technology in order to reap full benefits of technology.

SMEs should be encouraged to recruit staff with the required qualification to match the growth of the SMEs. Commercial banks should have tailor made loan products which are flexible and easy to understand.
SMEs should also be encouraged to diversify their products and move from the traditional practice of not venturing into other products.

Further, SMEs should be advised to strengthen and put up policies regarding debtors on how to collect receivables, be able to know when to write off bad debts so as to minimize losses that accrue as a result of non-payment. Similarly, efforts should be put by SME owners to ensure that inventory management is improved through setting re-order levels both for minimum and maximum so that the business does not run out of stock as well as tie too much capital in stock which affects the working capital.

The ministries of finance and industrialization should provide a favorable platform for SMEs to access financing that can enable them to run their businesses at a reasonable cost of financing. This is necessary since access to bank loans was found to be difficult for SMEs and end up using only internally generated funds. The interest rates should be favorable; similarly the requirements to accessing such funding should also be reasonable so as not to push SMEs away.

ICPAK and financial expertise should sensitize the SMEs owners on the relevance of bookkeeping, financial reporting and analysis as well maintaining proper books of analysis. Capacity building should be organized for SMEs owners to help them understand why they should keep updated books so as to know their levels of performance on whether they are making profits or losses.

References

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