FACTORS THAT AFFECT FINANCIAL PERFORMANCE
OF SMALL AND MEDIUM ENTERPRISES IN KENYA

BY

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UNITED STATES INTERNATIONAL UNIVERSITY-
AFRICA

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UNITED STATES INTERNATIONAL UNIVERSITY-
AFRICA
SUMMER, 2016

DECLARATION

I the undersigned, hereby declare that this research project is my own original work and has not been presented to any other university, college, and institution of higher learning or otherwise for academic credit other than the United States International University.

Sign --------------------------------- Date-------------------------------------

Fredrick Nakhaima (ID. No: 639444)

This research project has been presented for examination with my approval as the authorized supervisor.

Sign --------------------------------- Date-------------------------------------

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ACKNOWLEDGEMENT

This research project is the product of intense analysis of data and findings. The actualization of this research project has been made possible by various individuals and organizations. While it is impossible to name each of the individuals by name, it is my pleasure to acknowledge any individual who contributed to the completion of this study either indirectly or directly. May God Bless you all. However, I will mention a few individuals by names.

First to my Supervisor Mr. Kepha Oyaro who was key to the completion of this study by providing intellectual advice and guidance on the completion of this project. He has been the source of my inspiration to complete the project.

Secondly, to my family who stood with me in the conduct of this project. Their support was critical and key.

Finally, to all SME’s who participated in this research, thank you a great deal for your support.
DEDICATION

A special dedication to my family
ABSTRACT

The purpose of this study was to determine factors that affect financial performance of small and medium enterprises (SMEs) in Kenya. The research questions for this study were: What was the effect of corporate governance on financial performance in the SMEs in Kenya, the effect of human resource capacity on financial performance of SMEs and the influence of access to financing on financial performance of SMEs?

A descriptive research design was adopted for this study. The target population of the study included the 4,560 SMEs in Nairobi County. Data available from the Ministry of Trade and Ministry of Industrialization, (2013) revealed that there were 2500 SMEs in Manufacturing, 1500 SMEs Trading and 560 SMEs in the service industry. Stratified sampling technique was used to determine a sample size of 100 from the total population. For this study, data was collected using structured questionnaires based on the research questions. Descriptive statistics included frequencies distribution, and percentages and mean, while inferential statistical analysis used included correlations, and regression.

The first research question of the study was to investigate the influence of corporate Governance on financial performance of SMEs. The findings of the study indicated that majority (81.6%) of the respondents agreed that corporate governance affects financial performance. Equally, the study findings revealed a positive relationship between corporate governance and financial performance, \( r = 0.491 \) \( p < 0.05 \).

The second research question of the study was to determine the effect of human resource on financial performance of SMEs. The study findings indicated that majority (89.5%) of the respondents agreed that HR department ensures that employees are conversant with new trends in technology adopted in market. The study findings also revealed that there existed a strong positive relationship between human resource and financial performance, \( r = 0.414 \) \( p < 0.05 \), indicating the relationship was statistically significant.

The third research question of the study was to determine whether access to financing affects financial performance of SMEs. According to the findings, the majority (81.6%) of the respondents agreed that access to financing was important for growth of SMEs \( r = 0.612 \); \( p < 0.05 \). The relationship was therefore statistically significant. In conclusion corporate governance, human resource and access to finance were statistically significant.
in explaining financial performance. This implies that SMEs generally had effective factors that improved their financial performance.

Results led to the conclusion that corporate governance is a key determinant of financial performance. Results also led to conclusion that the SMEs had embraced and put into practice the structures of corporate governance and it worked for their good. The study clearly demonstrated the importance and the impact of human resource capacity on financial performance. SMEs ensured that their workers were being trained well for the betterment of the firms. The study came to a conclusion that access to finances was a key determinant of financial performance. Accessing bank loans easily improved the financial status of SMEs that subsequently led to reduction on the cost of finance which included higher interest rates, application fees, loan insurance premium, and legal fees. This in turn made it easy for SMES to grow as accessing finance became easier and less costly.

The study recommended that the government of Kenya be supportive to the SMEs by providing incentives to help them in implementing the corporate governance practices. SMEs were also encouraged to embrace corporate governance to the fullest to achieve better financial performance. SMEs were also recommended to consider financial monitoring to be done by the board and managers and board sub-committees. The board and managers also needed to be enlightened on the importance of corporate governance. The study recommended that SMEs should encourage employees training, compensation, performance appraisal and employee participation which were significant components to SMEs performance.
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<tr>
<td>CFO</td>
<td>Chief Finance Officer</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GoK</td>
<td>Government of Kenya</td>
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<td>HR</td>
<td>Human Resources</td>
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<td>HRD</td>
<td>Human Resource Development</td>
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<td>IPO</td>
<td>Initial Public Offering</td>
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<td>OECD</td>
<td>Organization of Economic Cooperation and Development</td>
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<td>OJT</td>
<td>On the Job Training</td>
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<td>SHRM</td>
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

The SMEs sector is increasingly viewed as an important engine for job creation and economic growth. This has been necessitated by the increasing awareness within the government that large projects in the industrial sector are less likely to generate the requisite employment opportunities, given the high capital-intensity of output in the sector.

The importance of finances has been viewed as a critical element for financial performance of small and medium-sized enterprises. Limit to financial hinder growth and development of these firms (Levy, 2015). Typically, smaller enterprises face higher transactions costs than larger enterprises in obtaining credit (Saito and Villanueva, 2000). Poor management and accounting practices is also a major factor that hinders financial performance of these firms and it hampers the ability of smaller enterprises to raise finance. Information asymmetries associated with lending to small scale borrowers have restricted the flow of finance to smaller enterprises. In spite of these claims however, some studies show a large number of small enterprises fail because of non-financial reasons (Liedholm, MacPherson & Chuta, 2007). Study by Tushabonwe-Kazooba, (2006) asserted that poor record keeping and lack of basic business management experience and skills are major contributors to failure of small business. Researchers have also acknowledged lack of access to external finance and weak capital base, inexperience in the field of business, particularly lack of technical knowledge plus inadequate managerial skills, lack of planning and lack of market research as causes of small business failure (Van Stel and Storey 2004). The solution for solving problems of economic growth in developing countries often resides in the performance of small scale industries. It is expected that the gains to be derived from the establishment of small-scale industries will be translated into the generation of employment at a low investment cost.

According to Subhan et al., (2013), SMEs are the driving force for the promotion of an economy. Due to their significance, all the countries either, developed or developing, are concentrating on the development of SMEs. He also argued that, Small enterprises are
considered as main driver for innovation, poverty reduction, employment generation, and social integration. SMEs sector may amplify the production capacity which has significant impact for the promotion of economic and social development. Avendano (2013) mentioned that, SMEs provide the vast majority of employment in developing countries and are keystones in the productive structures of emerging economies.

Majority of the SMEs are micro enterprises with fewer than 10 employees, while 70 per cent of them are one person, own account workers. This means that majority of SME entrepreneurs are operating at the bottom of the economy, with a significant percentage falling among the 53 percent of Kenyans living below the poverty line of USD 1 per day. The latter are largely for subsistence and engage in economically uncompetitive activities both in urban and rural areas (Kihonge, 2014).

A positive relationship has been documented between small-business development and economic growth in developed countries (Harris and Gibson, 2006; Monk, 2000; Sauser, 2005). However, not much research has been conducted on this relationship in developing countries. Studies in small-business development and performance are necessary in countries like Kenya because of the dissimilarities in the process between developed and developing countries (Arinaitwe, 2002). It is also essential to understand the factors influencing small-business performance in African countries because they are significantly different from those facing developed countries. These factors include: availability of business information, access to finance, availability of managerial experience and access to infrastructure.

The First 1993 Small & Medium Enterprises (SME) baseline survey revealed that there were approximately 910,000 SMEs employing up to 2 million people. The second SME baseline survey (1995), estimated the size of the SME sector at 708,000 enterprises employing up to 1.2 million people. Compared to the other sectors of the economy, the contribution of the SME sector to the country’s Gross Domestic Product (GDP) increased from 13.8% in 1993 to over 18% in 1999, (Sessional Paper No. 2 of 2005). Currently, it is estimated that the contribution to the GDP by this sector stands at over 25% (Economic Survey, 2012).
Corporate governance can be defined as “the process and structure used to direct and manage the business affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interest of other stakeholders” (Klapper and Panos, 2007). In the SME sector, corporate governance revolves around the roles of shareholders as owners and the managers of this companies often referred to as agents. There exists a conflict of interest in the goals that the managers as agents pursue and those of the owners or stakeholders. This therefore creates an agency problem that is often resolved through corporate governance. In SMEs, the resources, stewardship and control offered by directors for instance may be very different from and more direct than in large corporations. Corporate governance has gained importance amongst managers, scholars and other interested stakeholders especially for companies owned by the public or in public listed companies. In adequate empirical and theoretical literature with respect to SMEs have focused mainly on developed economies (Berger and Udell, 2002).

The issue is of critical significance given the important role that SMEs play in the Kenyan economy. A number of factors however hinder the adoption of corporate governance amongst SME’s, notable amongst which the lack of adequate financing (Ngugi and Bwisa, 2013). The problem of financing has been argued to be the main reason for many SMEs failing to start or progress. This stems from the fact that SMEs have limited access to capital markets, locally and internationally, in part because of the perception of higher risk, informational barriers, and the higher costs of intermediation for smaller firms. As a result, they often cannot obtain long-term finance in the form of debt and equity (Meyer-Stamer and Waltring, 2004). Also, banks and other formal finance providers are often reluctant to extend credit to SMEs. Lack of managerial competencies and proper governance systems in the SME sector have been identified to swamp efforts at attracting such finance and thus are said to be the main barriers to SME development and sound financial performance (Dockel and Ligthelm, 2005). It is necessary then for proper management of the SME sector to ensure enhanced performance, given that this would have major implications for financing opportunities for the sector.
1.2 Statement of the Problem

In Kenya, the SME sector is considered as one of the major contributors to the economy by providing income and employment to a significant proportion of the population (Ngugi & Bwisa, 2013). The Kenya Economic Survey report (GoK, 2009) showed that the SME sector contributed 79.8% of new jobs created in Kenya in year 2009. In 2012 the SME segment contributed over 80% of the country’s employment with majority of new jobs being created in that sector (430,000 out of 503,000 new jobs created in 2011) and contributes about 70% to the country’s GDP (GoK, 2012).

Despite the SMEs importance to the Kenyan economy, Sessional Paper No. 2 of 2005 indicates that three out of five businesses fail within the first three years of operation (GoK, 2009). The failure of SMEs leads to loss of jobs and consequently increased insecurity, low liquidity in the economy, and decline in economic growth. Ganbold (2008), noted that there had been a major challenge of limited resources thus making SMEs be managed in non-professional form as many of the entrepreneurs lacked sufficient resources to effectively engage all factors of production sufficiently. The human resources remain to be the largest causality as the proprietors rarely invested in this. Lack of specialization of duties and weak governance issues leave these small firms prone to having misrepresented reports. The financial reports which give general overview of the financial health of the organizations may at times give false information as the books of account are prepared by individuals with limited experience and knowledge. In cases where the finance staffs are well trained, they usually become overwhelmed as the play different roles including acting as human resource in charge, administration manager and at times operations manager (Abor and Adjasi, 2007). It is in the light of these facts that the world has come to appreciate the problem facing most of the SMEs in Kenya.

Many researchers have written a lot on factors affecting financial performance of SMEs in different areas around the world. For, example, Kirui. M (2002) conducted a research on “ Challenges facing SMEs in Kenya”, Subhan et al, (2013) conducted a research on “Innovation in SMEs and impact of economic development in Pakistan”, Monge.G et al,(2005) conducted a research on “Information and Communication Technologies and SMEs performance in Costa Rica”, Olugbenga and Ekiti (2012) conducted a research on
“Policy support and performance of SMEs enterprises in South west Nigeria”, and Seker and Correa (2010) they also conducted a research to study the “Obstacles to growth for SMEs in Turkey. However none of these studies has focused on the factors that affect financial performance of small and medium enterprises (SMEs) in Kenya.

1.3 Purpose of the Study

The study aimed at examining the factors that affect financial performance of small and medium enterprises (SMEs) in Kenya

1.4 Research Questions

1.4.1 What was the effect of governance on financial performance of the SMEs in Kenya?
1.4.2 What was the effect of human resource capacity on financial performance of SMEs?
1.4.3 What was the influence of access to financing on financial performance of SMEs?

1.5 Importance of the Study

1.5.1 Proprietors in the SMEs sector

The study is useful for proprietors in the SMEs sector as it helps them take note of the factors that affect financial performance of the SMEs.

1.5.2 Financial Institutions

The study is of use to financial institutions that are keen in financing SMEs as they are able to know key things to use when analyzing ability of a business to remain financially sound.

1.5.3 Kenyan Government

The study is useful for the Kenyan government as its findings may help the government in coming up with good frameworks and policies that will help in streamlining operations in the SME sector.
1.6 Scope of the Study

The scope of this study was Nairobi County and the research subject was formally registered SMEs based in that county. In total there were 4560 registered SME’s in the county that formed the population of the study. The period for data collection for this study was October 2015.

The main limitations of the study was the cooperation from the proprietors since the study required collection of first hand data from them and therefore dependent on their availability. To overcome this challenge the researcher utilized a mixture of online as well as personally administered questionnaires to have higher response rate.

1.7 Definition of Terms

1.7.1 Small and Medium Enterprises (SMEs)

Davis (1996), considers small and medium-sized business as privately held firms with 1-9 and 10-99 people employed, respectively. Stephanou and Rodriguez (2008) looks at SMEs as small independent private limited companies with less than 200 employees and Lo´pez and Aybar (2000) analyzed companies with sales below 15 million euros.

1.7.2 Corporate Governance

According to Mayer (1997), corporate governance is concerned with ways of bringing the interests of management and investors into line and ensuring that firms are run for the benefit of investors. Abor and Adjasi (2007) define corporate governance as the structures, processes, cultures and systems that engender the successful operation of the organisations.

1.7.3 Access to financing

Access to financing is the ability of individuals or enterprises to obtain financial services, including credit, deposit, payment, insurance, and other risk management services (Kipilyango 2012).

1.7.4 Financial Performance

A subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall
financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Natalie, 2014).

1.7.5 Debt Financing

This is cash borrowed from a lender at a fixed rate of interest and with a predetermined maturity date. The principal must be paid back in full by the maturity date, but periodic repayments of principal may be part of the loan arrangement (Beck, Demirgüç & Martinez, 2010).

1.7.6 Human Resource Development

Is a set of systematic and planned activities designed by an organization to provide its members with the opportunities to learn necessary skills to meet current and future job demands (Werner and DeSimone, 2006). According to Khan and Khan (2011) HRD is the process of determining the optimum methods of developing and improving the human resources of an organization and the systematic improvement of the performance of employees through training, education and development and leadership for the mutual attainment of organizational and personal goals.

1.8 Chapter Summary

This chapter presented the background and introductory framework to the subject study. In addition, the chapter addressed the problem that the study seeks to solve as well as the research questions. Further, the chapter presented the scope of the study, importance of the study and definition of key terms in the study.

Chapter two reviews the empirical literature on the various research questions of this study. The chapter also presents a summary of the literature. Chapter three presents the research methodology and design used in the study including the population and sampling techniques, the research procedures, data collection and analysis. Chapter four presents the findings and results of the study which are discussed in details in Chapter five. In addition, chapter five presents conclusions and recommendations of the study.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter reviewed the literature on factors affecting financial performance of SMEs in Kenya. The first section reviewed literature on governance and the financial performance of SMEs. The second part looked at how human resource capacity affect financial performance of SMEs and the last part focused on the effect of access to finance on financial performance of SMEs. The section ended with a chapter summary.

2.2 Effect of Corporate Governance on Financial Performance of SMEs

Corporate governance in the developed countries and especially in the SME sector is conceptualized through the use of codes, guidelines and principles of corporate governance. Though corporate governance exist, their adoption amongst SME’s is very low or loosely applied. However, it is critical for SME’s to adopt corporate governance (Abor, 2007). Corporate governance enhances greater financial performance and sustainability of the firm as well as acts as a catalyst for the growth and expansion of SME’s.

2.2.1 Definition of Corporate Governance

According to Jensen (2007) corporate governance refers to the structures, systems and processes that firms use to direct and control the business affairs of the company with the aim of enhancing business prosperity, growth and accountability with the ultimate goal of increasing shareholders value and wealth and promoting the interests and values of all the other stakeholders in the business. According to Claessens et al., (2002) corporate governance in companies offer frameworks for easier access to funds, lower costs of capital, improved financial performance and a positive brand image and brand perception amongst the stakeholders.

In the past, corporate governance was identified as a tool for large companies and corporations which was presumed to have agency problems (Claessens et al., 2002). However, in the modern environment corporate governance has arisen even amongst the
SME’s due to the importance and role of SME’s in economic prosperity and growth in the country.

Agency problems occur due to the presence of an agent principal relationship. In this case the principal (shareholders) cede their management control and direction to the managers (agents) with specific instructions on the goals and expectations of the shareholders. However, the managers can ignore the needs, expectations and goals of the shareholders and pursue their own selfish interests. Furthermore, the calls for separation of ownership and management of companies has led to increase in the calls for corporate governance and agency problems across the globe.

Claessens et al., (2002) noted that corporate governance does apply to SME’s and is indeed very acute amongst SME’s. According to the scholars, most SME’s are owned and managed by the owner as sole proprietors. This therefore does not create opportunities for separation of ownership and management in comparison to corporations and large firms. In addition, calls for corporate governance in SME’s is muted due to low number of employees in SME’s and most of whom are relatives or friends of the manager. Furthermore, most SME’s are not public entities and thus have no responsibility to the public as investors which reduces the calls for corporate governance amongst the SME’s. Due to this characteristics, it is very hard to find laws and regulations necessitating the SME’s to comply with disclosure regulations or strict regulations on the management and reporting of the firms. Consequently, there arises no agency problem, no need to maximize profit and market value due to the lack of investor concerns. Furthermore, no disagreements arise in most SME’s due to their nature of ownership which does not necessitate the need for corporate governance (Claessens et al., 2002).

Corporate governance mechanisms assure investors in corporations that they will receive adequate returns on their investments (Shleifer and Vishny, 2006). If these mechanisms did not exist or did not function properly, outside investors would not lend to firms or buy their equity securities. Overall, economic performance would likely suffer because many good business opportunities would be missed and temporary financial problems at individual firms would spread quickly to other firms, employees and consumers. Previous evidence suggests that corporate governance has a positive influence over corporate performance. For example, based on industry-level view, Rajan and Zingales (1998) find that firms in industries that require large amounts of external financing grow faster in
countries with high scores on their measures of financial development. Thus, corporate governance (measured through better accounting standards, stronger legal protection of investors, and a stronger rule of law) appears to matter for financial performance. In addition, Williams (2000), Drobetz et al. (2005) and Gemmill and Thomas (2004) concluded in their respective studies that there is a positive relationship between good corporate governance practices and firm value. A widely accepted statement is that good corporate governance results in a lower cost of capital.

2.2.2. Separation of Owners from Manager

According to Friedman (1970) the separation of management and control is similar to the separation of managers and owners. This process of managerial and ownership separation. This process is most conspicuous to the large companies where managers are accountable to owners. In companies where corporate governance is entrenched, the misunderstandings, fallouts and differences in opinions and views of the management and owners is often diffused and sorted through the corporate governance mechanisms and frameworks. In addition, when the SME needs funds for expansion corporate governance becomes very critical. This is especially so when the company is seeking to raise funds in the public markets such as the stock markets or the bond markets which have strong listing regulations on disclosures and corporate governance (Demsetz and Villalonga, 2001).

Langat (2006) conducted a cross-sectional survey to identify different governance structures between companies facing decline in value, those with appreciating values and those with stable values over the period 2001-2005. The study targeted 47 companies listed in the NSE for the five year period. Secondary data collected mainly from annual reports and financial statements of the firms were used, with Tobin’s Q (the performance measure) for the firms computed at the end of each financial year. The study found out that firms that are outsider-dominated (where the ratio of non-executive directors is greater than 60%) exhibited improved performance than firms with mixed boards (40-60% domination) and insider-dominated boards (up to 40% domination).

Demsets and Villalonga (2001) further argued that consistency in corporate governance adoption assists the business to create a positive brand image and reputation which is used in the growth and expansion of the company. A company that adopts corporate governance at an early stage has higher chances of survival and growth than a company
that does not adopt corporate governance. This is because corporate governance instills discipline in the company. This reputation becomes important and essential when the company is seeking funds from financial institutions and investors. Corporate governance stipulates that companies undertake proper book keeping and ensures that the financial accounts and books are audited on a regular basis. The consequences for this is that, the business is ready for new investors and additional capital (Harris and Raviv, 1991).

Corporate governance requires that the firm adopts roles in audit, remuneration and nomination of senior managers and directors which imply that the business has to higher additional directors. Furthermore, the presence of non executive directors imply that the company has to incur additional charges on remuneration of directors. Furthermore, for start ups the cost of introducing corporate governance will increase the total cost of the business which may distract SME’s. However, the potential benefits of corporate governance surpass the costs incurred in implementing corporate governance in the company (Demsetz & Villalonga, 2001).

2.2.3 Effect of Corporate Governance on Financial Performance of SME

Corporate governance as a subject has gained the interest of major stakeholders in the business and academic fraternity. Nevertheless, literature on the adoption of corporate governance amongst SME’s has largely focused on the developed countries and left a gap amongst the developing countries (Eisenberg et al., 2006; Bennett and Robson, 2004). Sahin, Basfirinci, and Ozsalih (2011) and Cherono (2008) concur that effective use of committees can improve the quality and efficiency of the board and add that to be effective, their work, role, responsibilities and mandates must be clearly defined. The argument for the formation of board committees is supported by the resource dependency theory which views them as sources of additional resources.

BBV Microfinance Foundation (2011), advice that each institution must choose the suitable number of committees for the board’s work. Too many committees can result in too many meetings and excessive distribution of work. At the other extreme, too few committees can turn the board meetings in long tedious sessions with too little time to deal with issues sufficiently in-depth in order to fulfill the assigned responsibilities efficiently. It further recommends that each committee must be formed by at least two
directors and if necessary, a specialist staff to support the specific work carried out by the committee. The most common board committees are audit, nominating and remuneration committees (BBV Microfinance Foundation, 2011b; Cherono, 2008). Prior studies have shown that the presence of board committees has a positive effect on a firm performance especially the financial performance as most critical processes and decisions are derived from board subcommittees (Heenetigala, 2011; Roche, 2005; Leffort and Ayuso et al, (2007) found that the existence of a committee that is composed of stakeholders or that is dedicated to social performance was strategically important for integrating stakeholder’s interest to collective decision making. The studies seem to all agree that as a result of the monitoring function of the board, board committees affect performance.

Dehaene et al. (2001) find that board size is positively related to company performance. However, the results of Abdul and Haneem (2006) are inconclusive. Using a market return measure of performance, their results suggest that a large board is seen as less effective in monitoring performance, but when accounting returns are used, large boards seem to provide the firms with the diversity in contacts, experience and expertise needed to enhance performance of SMES.

Guest (2009) examined the impact of corporate governance in SMEs in UK he assets that board size on firm performance for a large sample of 2,746 UK listed firms over 1981-2002. Secondary data on board size and financial performance was collected from “DataStream” and regression analysis used to analyze the data collected. They noted that the UK provided an interesting institutional setting, because UK boards play a weak monitoring role and therefore any negative effect of large board size is likely to reflect the malfunction of the board’s advisory rather than monitoring role. They found that board size has a strong negative impact on profitability, Tobin’s Q and share returns. They also found that the negative relation is strongest for large firms, which tended to have larger boards. Overall, their evidence supports the argument that problems of poor communication and decision-making undermine the effectiveness of large boards.

A study conducted by Gockel and Akoena (2002) on corporate governance in Ghana, it findings were that corporate governance enhances new strategic looks for firms and also promotes entrepreneurship and competitiveness of the SME. Corporate governance does not stifle growth of innovation and creativity in the work place. According to Petra
(2005), good corporate governance aims at increasing profitability and efficiency of organizations and their enhanced ability to create wealth for shareholders, increased employment opportunities with better terms for workers and benefits to stakeholders. Indicators of Good Corporate Governance identified in the study include independent directors, independence of committees, board size, split chairman/CEO roles and the board meetings. Thus, the main tasks of corporate governance refer to: assuring corporate efficiency and mitigating arising conflicts providing for transparency and legitimacy of corporate activity, lowering risk for investments and providing high returns for investors and delivering framework for managerial accountability.

Locally several studies have been done on the effect of corporate governance on financial performance. Muriithi, (2004) studied the relationship between corporate governance mechanisms and performance of firms and found that the size and the composition of the board of directors together with the separation of the control and the management have the greatest effect on the performance. Ngugi (2007) did a study on the relationship between corporate governance structures and the performance of insurance companies in Kenya and found that inside directors are more familiar with the firm's activities and they can act as monitors to top management especially if they perceive the opportunity to advance into positions held by incompetent executives. The study also found that the effectiveness of a board depends on the optimal mix of inside and outside directors concluding that an optimal board composition lead to better performance of the companies.

2.3 Effect of Human Resource Capacity on Financial performance of SMEs

HRM has largely been ignored by SME’s despite being, “fruitful subjects for empirical investigation because of their increasing numbers and market contexts and not least the diversity in the qualitative aspects of their management practices” (Morissette, 1993). In a similar way, it can be argued that SME’s often ignore the value of human resources in the strategic assets of the company and using the human capital as a source of competitive advantage. This can be attributed to the lack of resources to employ human resources in comparison large companies that have adequate resources for growth and expansion of human resources (Morissette, 1993; Ng and Maki, 1993). In addition, most SME’s lack
the expertise and knowledge on human resource training and development which is critical to implement human resource best practices (Bartram and Wang, 2005).

SME’s are a disadvantage in comparison to large corporations when it comes to human resource management. According to Bartram and Wang (2005) SME’s do not have the ability to retain, attract, motivate and develop the best human capital. However, SME’s have a higher level of flexibility in human resource innovativeness and entrepreneurial approaches to HRM.

2.3.1 The Concept of Human Capacity Development

Human resource development includes all the activities that are undertaken to improve the performance of employees and individuals in the organization or firm. The central goal in human resource development include training, development and progression of employees. Training includes all the activities that are aimed at promoting learning and knowledge acquisition in the firm (McLagan, 2007). Education and training have the primary goal of promoting development of employees and overall competence and duty service of the employee.

Beaver (2002) and Beaver and Jennings (2001) noted that SME’s must also embrace diversity and flexibility in its human resources. SME’s just like large corporations are bound by legislations and laws that stipulate diversification of human resources and development of human resources. Therefore, SME’s must undertake corrective and affirmative actions to enhance human resource development and growth in the workplace.

As the business environment changes, there must be changes in the operational framework of SME’s for seamless transition of employees to suit changing customer needs and demographic characteristics. Furthermore, managers of SME’s must be receptive of business needs, environmental needs and business core competencies to enhance sustainability of SME’s in the long term. This can be achieved through human resource development. ON the other hand, the adoption of human resource development will lead to competitive advantages for the SME’s (Evans et al., 2002; Acs, 2004).

Development on the other hand goes beyond learning and is aimed and enhancing the acquisition of competence, skills and quality of employees as well as enhancing employee motivation and commitment to the firm. Strategic human resource development on the other hand is concerned with the linkage between training and development to the overall
firm objectives and responding to the needs and demands of the environment (McLagan, 1989). SME’s are informal in nature, on the job and operate with very little if any kind of managerial supervision. Consequently, there is very little systems for on job training and training needs assessment (Marlowe and Patton, 1993; Loan-Clarke et al., 1999; MacMahon and Murphy, 1999). Kotey and Slade (2005) noted that training is often considered a very cost intensive exercise for SME’s an opinion echoed by (MacMahon and Murphy, 1999). Hornsby and Kuratko (1990) noted that the usage of different training methods in small firms under an on-the-job training framework is the most dominant method. Owners who act as managers therefore undertake the role of human resource management and training in the workplace (Wyer and Mason, 1998). Kotey and Slade (2005) found that the use of integrated training and development methods enhanced organization development and career progression amongst individuals, groups and organization. Human resource development has changed its course from mere training to providing future capability in the organization and individual growth. This has led to the focus on skills acquisition such as interpersonal skills and technical skills (Bucher and Sparks, 2011).

Education and skills are needed to run micro and small enterprises. Research shows that majority of the lot carrying out micro and small enterprises in Kenya are not quite well equipped in terms of education and skills. Studies suggest that those with more education and training are more likely to be successful in the SME sector (King & McGrath, 2002). As such, for small businesses to do well in Kenya, people need to be well informed in terms of skills and management. SMEs in ICT appear to be doing well with the sprouting of many commercial colleges offering various computer applications. Further, studies show that most of those running SMEs in this sector have at least attained college level education (Wanjohi & Mugure, 2008).

2.3.2 Organizational Culture as a support tool for Human Capacity Development

Beck (2009) noted that the change of values and opinions requires a systematic change in the efforts and activities that enhance the transformation of human resource managers and organization leaders. “The proportion of the working population employed in smaller firms, together with the personal and wealth creation implications for individuals in this sector not fulfilling their potential emphasizes the importance of the creation of company
cultures that encourage and value organizational learning, training and skills application” (Gleason and Wiggenhorn, 2000; Beaver and Jennings, 2001).

The integration of training and development in key business decision making processes is critical to the survival and growth of the firm. This is important because it allows for flexibility of transferring skills to people and addressing key shortage in the human resource framework and process for the firm (Kaufmann, 2006). Furthermore, Wyer and Mason (2008) and Stacey (2003) noted that small business face continuous changes in the work place which challenge the managers on how to cope with the change. Training and development of managers to be innovative is a key step towards realization of this goal. According to Jameson (2000) the presences or growth of a company has an effect on the perceptions towards training and participation. Therefore, for companies that engaging in expansion plans, there is a higher probability of training than in companies that are at early start up. However, most SME’s rely on the use of on the job training to undertake training and skills acquisition for employees.

It has been widely thought that training, development and education amongst most SME’s undertake an on-the-job training (OJT). This is due to the lower costs and preference for the use of adhoc training. Though OJT has the benefit of maximizing transfer of knowledge, it has its disadvantages since the supervisor may lack the requisite skills. Furthermore OJT does not provide opportunities and avenues for evaluation of the impact of training and development in the organization. This has led some SME’s to use external in house trainers which reduce the deficiencies and challenges associated with the use of on the job training in-house (Jameson, 2000).

Off-the-job training is more costly for smaller companies and can be difficult to organize, but it also offers expert training, minimal interruptions to daily work and can be quite efficient for small companies if they participate in “central” courses. Where this method is utilized by small companies it tends to be limited to seminars and classroom teaching rather than the potentially more useful simulations and programmed instructions.

Self-education of employees is rarely supported by SMEs because of financial constraints and the more advanced forms of training characteristic of organizational learning that promote life-long learning are also very rarely utilized either. Further, management development is often neglected in SMEs. Given that the organizational culture of a small firm often reflects the motivations, attitudes, values and abilities of the owner-manager,
exposure to training and development would ensure that owner-managers and managers in small businesses are provided with some of the requisite skills for coping with the change demands placed on modern organizations (Beaver, 2003). Moreover, the development of managers may contribute to organizational learning through improvements to organizational practices being embedded in the organization and becoming part of organizational culture through transition from one generation of employees to the next.

2.3.3 Effect of Human Resources Capacity on Financial Performance

The survival and success of any firm solely rely on its ability to integrate the right personnel at the right time and at the right place. Human resource management has been recognized by professionals as an important factor responsible for the competitiveness of firms and it assists firms to determine the key human resources management functional areas that is responsible for elevating the status of organizations. Acceptance and practices of human resources management in an organization result in a number of role changes and provide new challenges to the professionals in this discipline. That is, the more established the strategic roles for Human Resources (HR) functions, the more the expectation to partner with top management to achieve business success (Ogolla. 2011).

There have been many questions as to whether human resources practices can directly contribute to the implementation of the strategic objectives of small and medium enterprises (SMEs) and improve their performance (Oladipupo & Abdulkhadir, 2010). However, the establishment of Strategic Human Resources Management (SHRM) practices in (2007) has laid more emphasis on the strategic alignment of HRM practices with firm’s objectives, devolvement of responsibilities to line managers, training and development in organizations, compensation and reward systems, employee participation in decision making, appraisal and the value added by all these practices to the performance of organizations.

Human capacity has become a critical index of competition in the world of business to the extent that the development of such capacities through training has become top priority in designing the strategic plan of business organizations (Tim & Brinkerhoff, 2008). Management is therefore necessary to enable group or business goals to be accomplished through the functions of planning, staffing, directing, controlling activities,
coordination and directing. Personal characteristics of the owner/manager were interpreted as lack of experience among small business managers who happen to be the owners leading to poor performance and consequently to business failure.

Bambac and Lawyer (1997) identified that improper management is the root cause of many unsuccessful enterprises. Nzioka (2005) in the role of education in business performance notes that one of the things that hold back the development of small business is the need for better management. Good management means need for proper planning, control, organizing skills and proper staffing with qualified and competent employees.

According to Cant and Lightelm (2003) in a survey of small business failure maintain that entrepreneurs often have good ideas and are competent but they do not have a clue on how to run a business and have no underlying appreciation of business fundamentals. Professionalism is one of the areas that have failed the SMEs firms. Most of these firms only have unskilled labour and a small percentage of skilled labour and this majorly affects aspects of entrepreneurial firms. Experience takes many guises and breadth of experience is shown to be an important factor driving the performance of firms, with the number of previous jobs positively related to new firm performance (Lumpkin and Marvel, 2007).

The HRM that are adopted by firms do not directly influence firm performance. There are variables like employee outcomes which tend to affect performance of firms. (Boxall & Purcell, 2003) argue that there is a complex relationship between HRM and the achievement of organizational outcomes and that HR strategy is strongly influenced by national, sector and organizational factors. Employee outcomes like the competence, commitment and empowerment of employees to some extent affect firm performance.

In the relationship between HRMP and firm performance, organizational learning can contribute to the development of a firm’s resource based capability. When the knowledge and skills of employees are enhanced, employees are expected to perform their jobs and tasks more efficiently and effectively. This coupled with other variables in the workplace like employee empowerment, sharing of information in the organization and adoption of an appropriate competitive strategy, a firm can enhance its performance (Ehrenberg & Smith, 1994)
2.4 The Influence of Access to Finance on Financial Performance of SMEs

Lack of access to credit/finance is almost universally indicated as a key problem for SMEs. Credit constraints operate in variety of ways in Kenya where undeveloped capital market forces entrepreneurs to rely on self-financing or borrowing from friends or relatives which is not enough to enable SMEs undertake their business activities optimally. Lack of access to long-term credit for small enterprises forces them to rely on high cost short term finance. There are various financial challenges that face small enterprises. They include the high cost of credit, high bank charges and fees. The scenario witnessed in Kenya particularly during the climaxing period of the year 2008 testifies the need for credit among the common and low earning entrepreneurs. Numerous money lenders in the name of Pyramid schemes came up, promising hope among the ‘little investors,’ which they can make it to the financial freedom through soft borrowing. The rationale behind turning to these schemes among a good number of entrepreneurs is mainly to seek alternatives and soft credit with low interest rates while making profits. Financial constraint remains a major challenge facing SMEs in Kenya (Wanjohi and Mugure, 2008).

2.4.1 Sources of Capital

In South Africa Eeden (2004) finance was also cited as one of the most prominent constrains. The problem related to finance includes lack of information on where to source for finance, restrictive lending offered by commercial banks, lack of access to finance, insufficient financing, lack of track record required by the banks, limited access to collateral, and the fact that financial institutions lack appropriate structure for dealing with SMEs. Insufficient financing is as much a problem as lack of finance as Yankaya a consultant for an NGO Techno-Serve observes (Daily Nation 20.6.06). He notes that the proliferation of MFI has not substantially improved financing options for growth-oriented enterprises. Group lending and regular weekly interest payments are necessary cures to enable small-scale entrepreneurs without collateral to access credit but the same attributes tie down growth-oriented clients. As a result of scarcity of finance, small enterprises are unable to expand, modernize or meet urgent orders from customers. The profit margin are usually little to support growth.
Harper and Soon, (2009) notes that businesses like grain millers and tailors are unable to compete with large manufactures of ready-made goods because they have to wait until a customer provides them with raw material or money to buy it. Some may be unable to get started until a customer pays the deposit, which will be used to buy the raw material. Access to finance is essential for improving SMEs competitiveness, as SMEs have to invest in new technologies, skills and innovation. Access to finance issues cannot be resolved by implementing financing schemes or programs in a vacuum. There are institutional issues covering a spectrum from the macro level to the micro, which are accompanied by capacity deficiencies.

Macharia (2012) studied the effects of access to finance on micro and small enterprises investment growth in Ongata Rongai Township. The study found that in financing of the micro and small business, family and friends played a big role in helping the business owners boost their operations with an average of 40% of the finances coming from them, an average of 24% came from financial institutions while on average 30% of the finances were from business savings. The study also found that the main hindrance of SMEs in getting access to formal financial services due to lack of credit services awareness, lack of collateral, banks vetting procedures, requirements of a guarantor, cost of loans and the employment as a security issue are some of the obstacles hindering utilization of the available credit facilities.

Most studies (Ngobo, 2006; Kibera and Kiberam, 2010; Chijoriga and Cassiman, 2016), point to finance as one of the key constraints to small enterprise growth. This is worsened by the absence of financial markets in the developing countries. Small enterprise owners cannot easily access finance to expand business and they are usually faced with problems of collateral, feasibility studies and the unexplained bank charges. This means that they cannot access finance to enable them to grow. Ngobo (2006), makes a detailed analysis of finance as a constraining factor and includes collateral, interest rates, extra bank charges, inability to evaluate financial proposals and lack of financial management skills as hindrances to small enterprise growth. Under developed financial markets impose additional constraints. There are no financial instruments and no independent financial sources that are market driven.

Lack of access to credit/ finance is affects technology choice by limiting the number of alternatives that can be considered. Many SMEs may use inappropriate technology
because it is the only one they can afford. In some cases, even where credit is available, the entrepreneur may lack freedom of choice because the lending conditions may force the purchase of heavy, immovable equipment that can serve as collateral for the loan. Credit constraints operate in variety of ways in Kenya where undeveloped capital market forces entrepreneurs to rely on self-financing or borrowing from friends or relatives. Lack of access to long-term credit for small enterprises forces them to rely on high cost short term finance.

2.4.2 Accessibility to Loans

A study by Mwania, (2011) on the effect of Biashara Boresha Loan (BBL) on Performance of Micro and Small enterprises owned by Kenya Commercial Bank (KCB) Ruiru branch customers with objectives to review the lending procedures of biashara boresha loan, to assess the effect of BBL on MSEs performance and to find out the challenges faced in lending to SMEs, found out that besides BBL, there are other factors believed to have an effect on business performance. It also found no conclusive results on the relationship between entrepreneurs’ level of education and business performance. Of the 51% respondents who received training in their areas of business, 49.5% reported that their businesses were doing well, concluding that relevant training can produce positive results in the running of businesses.

A study by Mugo (2012) to investigate factors affecting women entrepreneurs’ performance in Central Business District (CBD) of the city of Nairobi, had the objectives, to assess the financial accessibility, assess the effect of record keeping challenges, to establish effect of budgeting on financial factors affecting women entrepreneurs’ performance, and to establish the effect of working capital management on the women entrepreneurs’ performance and accessibility to loan.

SMEs identify financing, especially medium to long-term finance, as their topmost obstacle to growth and investment. These obstacles come at two levels. In least developed economies, and in some transition and developing economies deficiencies in both the macroeconomic and microeconomic environments pose challenges: high budget deficits and unstable exchange rates and legal, regulatory and administrative environment poses major obstacles to access of SMEs to financing. In some economies, capital may just not be available, property rights regimes may not allow ownership of land, markets for
transfer of immovable assets may be very underdeveloped, credit and collateral legislation may not allow certain assets that SMEs commonly have access to, to be used as collateral, absence of registries for mortgages and pledges may increase risks to lenders, contract enforcement and asset liquidation may be hampered due to weaknesses in legislation and in the judiciary (Kinyanjui, 2006).

Finding start-up finance for the business is the biggest hurdle that many entrepreneurs go through. Even after getting started, getting sufficient finance to sustain business growth is another problem. Research findings by Daniels et al (2003) and Kinyanjui (2006) show how SMEs are constrained by finance. Studies undertaken by Kiiru, Mirero and Masaviro (2008) for Kenya Rural Enterprise Programme (K-Rep) confirm that a major constraint within the small business enterprise sector is financing. In the study carried in Nairobi among small manufacturing enterprises, Nyambura (2010) established that finance was rated among the biggest problem. Because of their smallness these enterprises end up using a cheap technology which is usually not top of the range. This results into high costs of production and uncompetitiveness. For instance small enterprises cannot afford to use computers or even where they have a computer, to continuously upgrade their equipment.

2.4.3 Effect of Access to Finance on Financial performance

The organization need to have sufficient funds and enough time to support the implementation process. True costs include realistic time commitment from staff to achieve a goal, a clear identification of expenses associated with a tactic, or unexpected cost overruns by vendors (Olsen, 2005). Lack of access of finances for small enterprises forces them to rely on high cost short term finance from relatives and friends. For instance; Numerous money lenders in the name of Pyramid schemes came up, promising hope among the ‘little investors,’ which they can make it to the financial freedom through soft borrowing. The rationale behind turning to these schemes among a good number of entrepreneurs is mainly to seek alternatives and soft credit with low interest rates while making profits. Financial constraint remains a major challenge facing SMEs in Kenya (Wanjohi and Mugure, 2008).

Ali (2011) examined the factors that affect financial sustainability of NGOs in Kenya with specific reference to Sisters Maternity Home (SIMAHO) in Garissa. The study
found that donor relationship management contribute most to financial sustainability of nongovernmental followed by strategic financial management then income diversification while own income generation contributed the least to financial sustainability of nongovernmental organizations. The study recommends that in order to ensure that the NGOs remain sustainable; they should procure employees that are competent in strategic planning and financial analysis.

Kinyua (2014), researching on factors affecting the performance of small and medium enterprises in the Jua Kali Sector in Nakuru town, Kenya with objectives to investigate the role of finance, management skills, macro-environment factors and infrastructure on performance of small and medium-sized enterprises in the Jua Kali sector in Nakuru town. The findings indicated that; that access to finance had the potential to positively affect performance of SMEs.

2.5 Chapter Summary

Corporate governance enhances greater financial performance and sustainability of the firm as well as acts as a catalyst for the growth and expansion of SME’s. However many SMEs do not embrace the corporate governance practices since the owners tend to think corporate governance is for large firms and not for small firms. Human resource capacity has a positive impact on financial performance of SMEs. However it can be argued that SME’s often ignore the value of human resources in the strategic assets of the company and using the human capital as a source of competitive advantage. This has been attributed to the lack of resources to employ human resources in comparison to large companies that have adequate resources for growth and expansion of human resources. This concept is greatly changing as SMEs have learnt that to achieve competitive advantage the firm should have competent human resource. Access to finance is a key determinant of financial performance of SMEs. With better financial performance, the credit risk of company’s becomes low leading to low cost of borrowing which enables SMEs to expand their businesses.

Chapter three enlightens on the research methodology of the study, it defines the research design, population and sample size together with the description on data collection which was used to carry out the study.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter described the techniques and procedures used in conducting the study. It comprised of the description of the population of the study, sampling techniques, sample size, methods of data collection and method of data analysis.

3.2 Research Design

This study was conducted through a descriptive case study research design. This design was suitable as it allowed an in-depth study of the factors affecting financial performance of SMEs in Kenya. According to Kothari (2004), a case study involves a careful and complete examination of a social unit, institution, family, cultural group or an entire community and embraces depth rather than breadth of the study. A descriptive case study is also advocated the study adopted a descriptive research design which according to Orodho (2003) involves collecting information by interviewing or administering a questionnaire to a sample of individuals. It is a method that drills down, rather than cast wide. The case study provided the researcher with in depth information, which assists in meeting the objectives of the study.

3.3 Population and Sampling Design

3.3.1 Population

Cooper and Schindler (2003), defines population as the subject that is measured therefore it is a unit of observation. An element is the subject on which the measurement is being taken. A sample is the subset of individuals from a population that is used to get an estimate of the characteristics of the entire population. The population of interest in this study was the SMEs that were formally registered and based in Nairobi County. The target population included the 4,560 SMEs in Nairobi County. Data available from the Ministry of Trade and Ministry of Industrialization, (2013) revealed that there were 2500 SMEs in Manufacturing, 1500 SMEs Trading and 560 SMEs in the service industry (RoK, 2014).
### Table 3.1: Population of the Study

<table>
<thead>
<tr>
<th>Category</th>
<th>Target Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>2500</td>
</tr>
<tr>
<td>Trade</td>
<td>1500</td>
</tr>
<tr>
<td>Services</td>
<td>560</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4560</strong></td>
</tr>
</tbody>
</table>

Source: ROK (2014)

### 3.3.2 Sampling Design

#### 3.3.2.1 Sampling Frame

A simple definition of a sampling frame is the set of source materials from which the sample is selected. The definition also encompasses the purpose of sampling frames, which is to provide a means for choosing the particular members of the target population that are to be interviewed in the survey (Turner, 2008). For this study, the sampling frame was sourced from Ministry of Industrialisation and Trade Development.

#### 3.3.2.2 Sampling Technique

Kombo and Tromp (2009) and Kothari (2004) also describe a sample as a collection of units chosen from the universe to represent it. Lavrakas (2008) describes a sample in a survey research context as a subset of elements drawn from a larger population. Polit and Beck (2003), strongly recommend that it is more practical and less costly to collect data from a sample than from an entire population. The study used probability sampling method when collecting data. The most effective sampling technique was stratified random sampling which was one of the sampling techniques under probability sampling. During data collection the targeted population for the study were the managers/administrators of the SME’s, they were picked randomly from each strata to provide information on how organizational factors have impacted growth and sustainability of their companies (Cooper and Schindler, 2003).

#### 3.3.2.3 Sample Size

The smaller size of the larger population is referred to as a sample size (Cooper and Schindler, 2008). The importance of a sample size is that it is very economical for the
researcher when they are doing their data collection. When the researcher limits studies to the population, it can be uneconomical because of producing results that are an inadequate presentation of the entire population size whereas an over-sized population size can be very expensive (Cooper and Schindler, 2008). At a confidence level of 90%, the margin of error is 10%. To obtain a sample size that has an adequate size relative to the goals of the study, the researcher adopted Yamane’s formula as follows:

\[ n = \frac{N}{1 + N(e)^2} \]

Where \( n \) is the sample size, \( N \) is the population size and \( e \) is the margin of error (Yamane, 1967).

\[ n = \frac{4560}{1 + 4560(0.1)^2} \]

A sample size of 100 respondents was used to analyze and achieve the specific objectives of the study. The sample size was distributed according to the numerical strength of the SMEs category to avoid biasness.

Table 3.2: Sample Size

<table>
<thead>
<tr>
<th>Category</th>
<th>Target Population</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>2500</td>
<td>55</td>
</tr>
<tr>
<td>Trade</td>
<td>1500</td>
<td>33</td>
</tr>
<tr>
<td>Services</td>
<td>560</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4560</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

3.4 Data Collection Methods

Primary data was collected through the administration of questionnaires. They were dropped at the various SMES and were picked after some days to allow for the filling by the selected respondents, some were sent via e-mails and filled by respondents then e-mailed back. Louis, Lawrence and Morrison (2007) describes primary data as those items that are original to the problem under study while Ember and Ember (2009) describe primary data as data collected by the investigator in various field sites explicitly for a comparative study. The study relied on primary data. The primary data was collected using semi-structured questionnaire which comprised of both open and closed ended questions. The questionnaire was based on a 5-point Likert scale. This scale was used to
quantify responses on items in the questionnaires. The 5-point Likert scale was adopted for the predictor and the predicted variables. This scale was selected so as to ensure that respondents make a definite choice rather than an inclination to a neutral response.

The questionnaire designed in this study comprised of three sections: how corporate governance can influence financial performance of SMEs; how human resource capacity can influence financial performance of SMEs; what is the effect of access to finances on the financial performance of SMEs in Kenya.

3.5 Research Procedures

The questionnaire was formulated for the two categories of research design, the qualitative and quantitative. The research instruments used in the study were developed based on the specific research objectives. A pilot test was conducted to adhere to the fundamentals described by Cooper and Schindler (2008) who defined pilot test as a tool that should be adminstired so as to detect weakness in the research design and the instruments. The pilot test was given to 10 respondents selected by the researcher conviniently. The respondents were managers/adminstrators of the SMEs so as to test how reliable, capable, and relevant the questionnaire is. The questionnaires were self administered by the researcher through hand delivery, courier, and e-mails. The researcher made follow ups to pick the fully completed questionnaires from the respondents in the event that respondents did not fill immediately and the researcher helped in the interpreting questions that seemed not clear or the respondents were unable to understand. This was done to ensure a high response rate.

3.6 Data Analysis Methods

Gray (2004) defined a codebook as a set of rules for assigning numerical values to answers obtained from the respondents. The collected data was coded prior to entering the collected quantitative data into the computer for data analysis thereafter the data was cleaned to ensure completeness of the information obtained. The study used both descriptive and inferential statistics. According to Cooper and Schindler (2008) descriptive analysis involves a process of transforming a mass of raw data into tables, charts, with frequency distribution and percentages, which are a vital part of making sense of the data. In this study, the descriptive statistics such as percentages and
frequency distribution were used to analyze the demographic profile of the participants. The demographic data was tabulated using frequency and percentages. In order to describe the data, the study used means and standard deviation of each variable. The data collected was statistically analyzed using the Statistical Program for Social Sciences (SPSS). The data was presented using table and figures.

3.7 Chapter Summary

This chapter highlighted the various methods and procedures the researcher adopted in conducting research on factors affecting financial performance of SMEs in Kenya in order to answer the research objectives that were raised in chapter one and needed to be addressed. The chapter equally highlighted the research design that was adopted for this study as well as the target population and sampling design, the research instruments utilized; the research procedures followed as well as the data analysis methods have also been discussed in this chapter and lastly the chapter summary.

Chapter four below presents the findings and results of the study based on the findings of data collected using methodologies identified in this chapter.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter deals with the analysis of data. The data analysis is in harmony with the specific objectives where patterns were investigated, interpreted and inferences drawn on them.

4.2 Response Rate

A total of 76 responses/Questionnaires were received out of 100 questionnaires. This translates to a response rate of 76%. According to Mugenda and Mugenda (2003) and also Kothari (2004) a response rate of 50% or more is ideal for data analysis. Babbie (2004) also asserted that return rate of 50% is acceptable to analyze and publish, 60% is good and 70% is very good. Based on these assertions from renowned scholars 76% response rate is adequate for the study.

4.3 General Information

This section analyzes the demographic characteristics of the respondents.

4.3.1 Gender of the Respondents

The respondent were asked to indicate their gender, figure 4.1 shows that majority of the respondents were male (70%) and female (30%).

Figure 4.1: Gender of the Respondents
4.3.2 Age of the Respondents

The Respondents were asked to indicate their age brackets. Table 4.1 illustrates that 42.1% of the respondents were aged between 36 and 50 years while 26.3% were aged between 20-35 years, 17.1% of the respondents were between 51-60 years and finally 14.5% of the respondent were aged between 18-20 years.

Table 4.1: Age of the Respondents

<table>
<thead>
<tr>
<th>Age</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>18–20 Years</td>
<td>11</td>
<td>14.5</td>
</tr>
<tr>
<td>20–35 Years</td>
<td>20</td>
<td>26.3</td>
</tr>
<tr>
<td>36–50 years</td>
<td>32</td>
<td>42.1</td>
</tr>
<tr>
<td>51–60</td>
<td>13</td>
<td>17.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>76</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

4.3.3 Position of the Respondent

The Respondents were asked to indicate their position in the organization. Table 4.2 indicates that 39.6% of the respondents were supervisory level while 31.5% were in middle management and 28.9% were in top management. Results implies that majority of the respondents were in top position and the information given will be accurate and useful to the research subject.

Table 4.2: Position of the Respondents

<table>
<thead>
<tr>
<th>Position</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top Management</td>
<td>22</td>
<td>28.9</td>
</tr>
<tr>
<td>Middle Management</td>
<td>30</td>
<td>31.5</td>
</tr>
<tr>
<td>Supervisory</td>
<td>24</td>
<td>39.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>76</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

4.3.4 Level of education

The Respondents were asked to indicate their education level. Study findings in Figure 4.2 indicate that 36% of the respondents had attained college level, 33% had reached university level, 21% has attained post graduate level and 10% had attained secondary level.
Figure 4.2: Level of Education

4.3.5 Years of Operation

The respondents were asked to indicate for how long they have worked in the organization. Figure 4.3 shows that 39% of the respondents indicated they had worked for 6-8 years, 34% had worked between 8-10 years, 15% indicated between 3 to 5 years and 12% had over 10 years. Results implies that majority of the respondents have worked long enough in their designated positions in the firm hence were in the best position to give accurate information need in the study.

Figure 4.3: Years of Operation
4.4 Financial Performance of firms

The study sought to determine the financial performance of SMEs firms in Kenya. The results were presented as follows.

4.4.1 Superior firm Performance

The respondents were asked to indicate whether firm’s superiority affects financial performance. A Majority of 82% of the respondent agrees with the statement. 13.2% were neutral and 3.9% disagreed. The finding implies that firm’s superiority affects financial performance. The results are presented in Table 4.3 below

Table 4.3: Superior firms Performance

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>We have superior firm performance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>1</td>
<td>1.3%</td>
</tr>
<tr>
<td>Disagree</td>
<td>2</td>
<td>2.6%</td>
</tr>
<tr>
<td>Neutral</td>
<td>10</td>
<td>13.2%</td>
</tr>
<tr>
<td>Agree</td>
<td>41</td>
<td>53.9%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>22</td>
<td>28.9%</td>
</tr>
</tbody>
</table>

4.4.2 Competitive Advantage influences Financial Performance

The respondents were asked to indicate on their agreements and disagreements on whether competitive advantage influences financial performance. Table 4.4% illustrates that majority 53.9% of the respondents agreed with the statement on competitive advantage and another 36.8% strongly agreed bringing to a total of 90.7% of those who agreed while 2.6% were neutral and 1.3% strongly disagreed and 5.3% of the respondents disagreed with the statement. The results imply that competitive advantage has an influence on the financial performance of the firms

Table 4.4: Competitive Advantage

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our company is highly profitable compared to our competitors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>1</td>
<td>1.3%</td>
</tr>
<tr>
<td>Disagree</td>
<td>4</td>
<td>5.3%</td>
</tr>
<tr>
<td>Neutral</td>
<td>2</td>
<td>2.6%</td>
</tr>
<tr>
<td>Agree</td>
<td>41</td>
<td>53.9%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>28</td>
<td>36.8%</td>
</tr>
</tbody>
</table>
4.4.3 Profitability

The respondents were asked to indicate on their agreement and disagreements on regarding firm’s profitability. Table 4.5 illustrates that 90.8% of those respondents agreed with the statement, three point nine of the respondents were neutral while 1.3% strongly disagreed and 3.9% disagreed. This result implies that profitability affects the financial performance of SMEs.

Table 4.5: Profitability

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our company is highly profitable compared to our competitors</td>
<td>Strongly disagree</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Disagree</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Neutral</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Agree</td>
<td>36</td>
</tr>
<tr>
<td></td>
<td>Strongly agree</td>
<td>33</td>
</tr>
</tbody>
</table>

4.4.4 Information and Communication Skills

The respondents were asked to indicate on their agreements and disagreements on whether information and communication skills, affects financial performance. Table 4.6 illustrates that 97.4% agreed with the statement. Four point three of the respondents were neutral while 2.6% disagreed. This result implies that information communication skill has a positive effect on the financial performance of SMEs.

Table 4.6: Information and Communication Skills

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Good information and communication skills are affecting our performance positively</td>
<td>Strongly disagree</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Disagree</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Neutral</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Agree</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>Strongly agree</td>
<td>44</td>
</tr>
</tbody>
</table>
4.4.5 Increase in total Revenue

The respondents were asked to indicate whether increase in total revenue affects financial performance. Table 4.7 illustrates that 93.5% of the respondents agrees with the statement, three point nine of the respondents were neutral while 2.6% disagreed. This result implies increase in total revenue positively affects financial of firms.

Table 4.7: Increase in total Revenue

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The business has experienced an increase in total revenue over the last 2 years</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>0</td>
<td>0.00%</td>
</tr>
<tr>
<td>Disagree</td>
<td>1</td>
<td>1.3%</td>
</tr>
<tr>
<td>Neutral</td>
<td>5</td>
<td>6.6%</td>
</tr>
<tr>
<td>Agree</td>
<td>30</td>
<td>39.5%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>40</td>
<td>52.6%</td>
</tr>
</tbody>
</table>

4.5 Corporate Governance

The first objective of the study was to investigate the influence of corporate governance on the financial performance of SMEs in Kenya. Corporate governance in the SME sector is conceptualized through the use of codes, guidelines and principles of corporate governance Corporate governance enhances greater financial perfomance and sustanability of the firm as well as acts as a catalyst for the growth and expansion of SME’s. The results were presented as follows

4.5.1 Role of CEO

The respondents were asked to indicate on their agreements and disagreements on whether the role of the CEO and that of the chairman is separated in their firms. Table 4.8 illustrates that 32.9%of the respondents agreed and another 40.8% strongly agreed bringing to a total of 73.7% of those who agreed. Seventeen point one percent were neutral and 5.3% strongly disagreed and 3.9% disagreed with the statement.
Table 4.8: Role of CEO

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The CEO’s role in our firm is separated from the chairman’s role</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>4</td>
<td>5.3%</td>
</tr>
<tr>
<td>Disagree</td>
<td>3</td>
<td>3.9%</td>
</tr>
<tr>
<td>Neutral</td>
<td>13</td>
<td>17.1%</td>
</tr>
<tr>
<td>Agree</td>
<td>25</td>
<td>32.9%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>31</td>
<td>40.8%</td>
</tr>
</tbody>
</table>

4.5.2 Audit Committee

The respondents were asked to indicate their agreements and disagreements on the statements whether the audit committee focus on improving the company performance and competitiveness. Table 4.9 illustrates that 89.5% of the respondents agreed with the statement, 1.3% strongly disagreed and another 3.9% disagreed and finally 5.3% were neutral.

Table 4.9: Audit Committee

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit committee focus on improving the company performance and competitiveness.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>1</td>
<td>1.3%</td>
</tr>
<tr>
<td>Disagree</td>
<td>3</td>
<td>3.9%</td>
</tr>
<tr>
<td>Neutral</td>
<td>4</td>
<td>5.3%</td>
</tr>
<tr>
<td>Agree</td>
<td>38</td>
<td>50%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>30</td>
<td>39.5%</td>
</tr>
</tbody>
</table>

4.5.3 Board Composition

The respondents were asked to indicate their agreement and disagreement on whether the composition of the board of their firm is a balance of executive and non-executive directors of diverse skills or expertise. Table 4.10 illustrates that majority 93.4% of the respondent agreed two point six were neutral and 1.3% strongly disagreed and 2.6 disagreed. This implies that board composition has an effect on financial performance.
Table 4.10: Board Composition

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The composition of the board of our firm is a balance of executive and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>non-executive directors of diverse skills or expertise.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>1</td>
<td>1.3%</td>
</tr>
<tr>
<td>Disagree</td>
<td>2</td>
<td>2.6%</td>
</tr>
<tr>
<td>Neutral</td>
<td>2</td>
<td>2.6%</td>
</tr>
<tr>
<td>Agree</td>
<td>39</td>
<td>51.3%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>32</td>
<td>42.1%</td>
</tr>
</tbody>
</table>

4.5.4 Quality and Effectiveness of Committee

The respondents were asked to indicate whether effective use of committees improve the quality and efficiency of the board responsibilities and mandates are clearly defined. Table 4.11 illustrates that majority 89.5% of respondents agreed, 9.2% were neutral and 1.3% disagreed. The results implied that quality and effective committee affects firm performance.

Table 4.11: Quality and Effectiveness of Committee

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The effective use of committees improve the quality and efficiency of</td>
<td></td>
<td></td>
</tr>
<tr>
<td>the board responsibilities and mandates are clearly defined</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>Disagree</td>
<td>1</td>
<td>1.3%</td>
</tr>
<tr>
<td>Neutral</td>
<td>7</td>
<td>9.2%</td>
</tr>
<tr>
<td>Agree</td>
<td>24</td>
<td>31.6%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>44</td>
<td>57.9%</td>
</tr>
</tbody>
</table>

4.5.5 Book Keeping

The respondent were asked to indicate if Corporate governance has stipulated proper book keeping and ensures that the financial accounts and books are audited on a regular basis. Table 4.11 illustrates that twenty seven point six agreed and 55.3% strongly agree bring the total of those who agrees to 82.9% of the respondents agreed and 3.9% strongly disagreed and 10.5% disagreed and finally 2.6% were neutral. Results of the study indicated that good book keeping is an indicator of financial performance.
Table 4.1: Book Keeping

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The effective use of committees improve the quality and efficiency of the board responsibilities and mandates are clearly defined</td>
<td>Strongly disagree</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Disagree</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Neutral</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Agree</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>Strongly agree</td>
<td>42</td>
</tr>
</tbody>
</table>

4.6 Human Resource Capacity

The second objective of the study was to determine the effect of human resource capacity on financial performance of SMEs. Human resource management has been recognized by professionals as an important factor responsible for the competitiveness of firms and it assists firms to determine the key human resources management functional area that is responsible for elevating the status of organizations. Acceptance and practices of human resources management in an organization result in a number of roles changes and provide new challenges to the professionals in this discipline for the betterment of the firm’s performance. Results are presented as follows.

4.6.1 Technology innovation

The respondents were asked to indicate whether HR department ensures that employees are conversant with new trends in technology adopted in market. Forty three point four agreed and 46.1% strongly agreed leading to 89.5% to those who agreed, 6.6% were neutral and 1.3% strongly disagreed and 2.6% disagreed Results are presented in table 4.12 below

Table 4.12: Technology innovation

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The HR departments ensures that employees are conversant with new trends in technology adopted in market</td>
<td>Strongly disagree</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Disagree</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Neutral</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Agree</td>
<td>33</td>
</tr>
<tr>
<td></td>
<td>Strongly agree</td>
<td>35</td>
</tr>
</tbody>
</table>
4.6.2 Finance Departments

The respondents were asked to indicate their advantages and disadvantages whether finance and accounting department are the most understaffed. Table 4.13 illustrates that 86.9% of the respondents agreed, 6.6% were neutral 1.3% strongly disagreed and 5.3% of the respondents disagreed.

Table 4.13: Finance Department

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance and accounting department are the most understaffed</td>
<td>Strongly disagree</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Disagree</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Neutral</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Agree</td>
<td>41</td>
</tr>
<tr>
<td></td>
<td>Strongly agree</td>
<td>25</td>
</tr>
</tbody>
</table>

4.6.3 Role of Accountants

The respondents were asked to indicate there agreements and disagreements whether accountants in most cases play roles of administration, human resources and even operations. Table 4.14 illustrates that majority 92.1% to those the respondents agreed with the statement, 5.3% were neutral 2.6% of the respondents disagreed.

Table 4.14: Role of Accountants

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accountants in most cases play roles of administration, human resources and even operations</td>
<td>Strongly disagree</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Disagree</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Neutral</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Agree</td>
<td>39</td>
</tr>
<tr>
<td></td>
<td>Strongly agree</td>
<td>31</td>
</tr>
</tbody>
</table>

4.6.4 Training and Development Programmes

The respondents were asked to indicate their agreements and disagreement on whether the company has put in place staff training and development programs. Table 4.15 illustrates that majority 92.1% of the respondent agreed with the statement and 1.3% strongly disagreed and another 3.9% of the respondent disagreed. The results implies that training and development are key factors in determining financial performance.
Table 4.15: Finance Department

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The company has put in place staff training and development programs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>1</td>
<td>1.3%</td>
</tr>
<tr>
<td>Disagree</td>
<td>3</td>
<td>3.9%</td>
</tr>
<tr>
<td>Neutral</td>
<td>2</td>
<td>2.6%</td>
</tr>
<tr>
<td>Agree</td>
<td>15</td>
<td>19.7%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>55</td>
<td>72.4%</td>
</tr>
</tbody>
</table>

4.6.5 Recruitment

The respondents were asked to indicate on their agreements and disagreements regarding whether the company hires best talent in the market and it has resources to retain them. Table 4.16 illustrates that majority 88.1% of the respondents agreed, 3.9% were neutral and 1.3% strongly disagreed and 6.6% of the respondents disagreed with the statement. Results implies that recruitment in terms of best talented in the market affects financial performance.

Table 4.16: Recruitment

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The company hires best talent in the market and it has resources to retain them</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>1</td>
<td>1.3%</td>
</tr>
<tr>
<td>Disagree</td>
<td>5</td>
<td>6.6%</td>
</tr>
<tr>
<td>Neutral</td>
<td>3</td>
<td>3.9%</td>
</tr>
<tr>
<td>Agree</td>
<td>21</td>
<td>27.6%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>46</td>
<td>60.5%</td>
</tr>
</tbody>
</table>

4.6.6 Well trained Accountants

In regard to the statement whether well trained and experienced accountant that help improve financial performance, table 4.17 illustrates that majority of 25% agreed and 57.9% strongly agreed leading to 82.9% to those who agreed 2.6% were neutral and 5.3 strongly disagrees and 9.2 of the respondents disagreed with the statement.

Table 4.17: Well-trained Accountants

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Well trained and experienced accountant help improve financial performance of the company.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>4</td>
<td>5.3%</td>
</tr>
<tr>
<td>Disagree</td>
<td>7</td>
<td>9.2%</td>
</tr>
<tr>
<td>Neutral</td>
<td>2</td>
<td>2.6%</td>
</tr>
<tr>
<td>Agree</td>
<td>19</td>
<td>25%</td>
</tr>
</tbody>
</table>
The third objective of the study was to determine the influence of access to financing on the financial performance of SMEs. Access to financing boost operation of the business and hence improve its financial status. Results are presented as follows.

### 4.7 Access to Finances

The respondents were asked to indicate whether access to financing is important for growth of SMEs. Table 4.18 illustrates that 46.1% of the respondents agreed and another 42.1% strongly agreed bringing to a total of 88.2% of those who agreed. One point three percent of the respondent strongly disagreed and 2.6% disagreed while 7.9% were neutral. The result implies that access to finance is a key determinant of financial performance.

**Table 4.18: Access and Growth**

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to financing is important for growth of SMEs.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>1</td>
<td>1.3%</td>
</tr>
<tr>
<td>Disagree</td>
<td>2</td>
<td>2.6%</td>
</tr>
<tr>
<td>Neutral</td>
<td>6</td>
<td>7.9%</td>
</tr>
<tr>
<td>Agree</td>
<td>35</td>
<td>46.1%</td>
</tr>
<tr>
<td>Strongly agree</td>
<td>32</td>
<td>42.1%</td>
</tr>
</tbody>
</table>

### 4.7.2 Bank Loans

The respondents were asked to indicate whether bank loans are easily accessible and available for use to start up a business Table 4.19 illustrates that majority 32.9% of the respondents agreed and another 32.9% strongly agreed bringing to a total of 65.8% of those who agreed. Six point six percent of the respondents strongly disagreed while 22.4% disagreed and 5.3% were neutral.

**Table 4.19 Bank Loans**

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank loans are easily accessible and available for use to start up a business</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>5</td>
<td>6.6%</td>
</tr>
<tr>
<td>Disagree</td>
<td>17</td>
<td>22.4%</td>
</tr>
</tbody>
</table>
### 4.7.3 Credit Finance

The respondents were asked to indicate whether total credit finance accessed through semiformal financial sectors has positively affected my business. Table 4.20 illustrates that 34.2% of the respondents agreed and another 51.3% strongly agreed bringing to a total of 85.5% of those who agreed. One point three percent of the respondents strongly disagreed and 3.9 disagreed while 9.2% were neutral.

#### Table 4.20: Credit Finance

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total credit finance accessed through semiformal financial sectors has positively affected my business</td>
<td>Strongly disagree</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Disagree</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Neutral</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>Agree</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td>Strongly agree</td>
<td>39</td>
</tr>
</tbody>
</table>

### 4.7.4 Financial Institutions

The respondents were asked to indicate whether most financial institutions are reluctant to provide long-term credit to SMEs. Table 4.21 illustrates that 22.4% agreed and of 53.9% of the respondents strongly agreed bringing to the total of those who agreed to 76.3%, 2.6% disagreed and 11.8% disagreed. The result implies that long term credits affects the financial performance of SMEs.

#### Table 4.21: Financial Institution

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Most financial institutions are reluctant to provide long-term credit to SMEs</td>
<td>Strongly disagree</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Disagree</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>Neutral</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>Agree</td>
<td>17</td>
</tr>
<tr>
<td></td>
<td>Strongly agree</td>
<td>41</td>
</tr>
</tbody>
</table>

### 4.7.5 Reduction on Cost of Finance
The respondents were asked to indicate whether Reduction on the cost of finance, that is interest rates, application fees, loan insurance premium, legal fees etc has made it easy for SMES to access financing, 35.5% of the respondents agreed and another 50% strongly agreed bringing to a total of 85.5% of those who agreed. One point three percent strongly disagreed and 9.2% disagreed while 3.9% were neutral. Results are presented in table 4.22 below

**Table 4.22: Reduction on Cost of Finance**

<table>
<thead>
<tr>
<th>Statement</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The effective use of committees improve the quality and efficiency of the board responsibilities and mandates are clearly defined</td>
<td>Strongly disagree</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Disagree</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>Neutral</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Agree</td>
<td>27</td>
</tr>
<tr>
<td></td>
<td>Strongly agree</td>
<td>38</td>
</tr>
</tbody>
</table>

4.8 Inferential

This section presents the correlation and regression analysis

4.8.1 Correlation

Table 4.23 displays the results of correlation test analysis between the dependent variable (financial performance) and independent variables and also correlation among the independent variables themselves. Results on Table 4.24 show that financial performance positively correlated with corporate governance, human resource and access to finance. This reveals that any positive change in corporate governance, human resource and access to finance to improved financial performance of SMEs.

**Table 4.23 Correlation between financial Performance, Human Resource, Access to Finance and Corporate Governance**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Financial Performance</th>
<th>Corporate Governance</th>
<th>Human Resource</th>
<th>Access to Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Performance</td>
<td>Pearson Correlation</td>
<td>0.491</td>
<td>0.259</td>
<td>1</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>Pearson Correlation</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Human</td>
<td>Pearson Correlation</td>
<td>0.414</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>
### 4.8.2 Model Summary

Table 4.24 shows that the coefficient of determination also called the R square is 84.3%. This means that the combined effect of the predictor variables (corporate governance, human resource capacity and access to finances) explains 0.843 of the variations in financial performance. This implies that the model is satisfactory as much of the variation is accounted for by the dependent variables identified in the model.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>R</td>
<td>0.918</td>
</tr>
<tr>
<td>R Square</td>
<td>0.843</td>
</tr>
<tr>
<td>Std. Error of the Estimate</td>
<td>0.15284</td>
</tr>
</tbody>
</table>

### 4.8.3 Goodness of Fit of Regression Model

Results on table 4.25 presents the goodness of fit of the regression model on the influence of corporate governance, human resource capacity and access to finances on financial performance of SMEs was statistically significant in explaining changes in financial performance. This is demonstrated by a p value of 0.000 which is less that the acceptance critical value of 0.05.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>9.015</td>
<td>3</td>
<td>3.005</td>
<td>128.638</td>
<td>0.000</td>
</tr>
<tr>
<td>Residual</td>
<td>1.682</td>
<td>72</td>
<td>0.023</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>10697</td>
<td>75</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 4.26 displays the regression coefficients of the independent variables. The results that corporate, governance, human resource capacity and access to finance affects financial performance positively and significantly.
Regression results indicate that corporate governance and financial performance had a positive and significant relationship (beta=0.214, p value 0.015). The findings imply that an increase in corporate governance by one unit leads to increased financial performance by 0.214, units. Results further indicate that human resource capacity and financial performance had a positive and significant relationship (beta=-0.224, p value 0.018). The findings imply that an increase in human resource capacity by one unit leads to improved client retention by 0.224 units.

Finally the results indicated that access to finance had a positive and significant relationship with financial performance (beta=0.364, p value 0.004). The findings imply that an increase in access to finances by one unit leads to increase in financial performance by 0.364 units.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Beta</th>
<th>Std. Error</th>
<th>T</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.938</td>
<td>0.455</td>
<td>2.062</td>
<td>0.043</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>0.214</td>
<td>0.086</td>
<td>2.484</td>
<td>0.015</td>
</tr>
<tr>
<td>Human resource Capacity</td>
<td>0.224</td>
<td>0.092</td>
<td>2.43</td>
<td>0.018</td>
</tr>
<tr>
<td>Access to Finances</td>
<td>0.364</td>
<td>0.081</td>
<td>4.509</td>
<td>0.00</td>
</tr>
</tbody>
</table>

4.9 Chapter Summary

This chapter presents the results and findings of the study based on data collected and analyzed. The findings indicated that corporate governance had a positive influence on the financial performance of SME’s in the study. Furthermore, the study found that human resource management and its activities such as staff training and development and reducing staff turnover were essential in enhancing firm performance amongst SME’s. The relationship between access to finances and financial performance was also investigated in this study. The study found that the access to bank loans, credits from financial institution had a positive influence on the financial performance of the SME. In addition, access to finances improved the overall firm value and enhances firm expansion.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of major findings of the study, relevant discussions, conclusions and the necessary recommendations. The study sought to determine the effect of corporate governance, human resource capacity and access to finance on the performance of the SMEs.

5.2 Summary

The general objective of this study was to determine the effect of financial performance of the SMEs. The specific objectives of this study were to determine to what extent corporate governance influences financial performance in SMEs to determine to what extent human resource capacity influences financial performance in SMEs and to determine to what extent does access to finances influence financial performance in the SMEs.

For purposes of collecting primary data, the use of a questionnaire developed by the researcher was used and their results analyzed using various statistical methods such as graphs, charts and with the aid of statistical tools such as Microsoft Excel and SPSS. A population size of on 4560 registered SMEs and a sample size of 100 SMEs was identified through stratified random sampling. A response rate of (76%) was achieved out of a possible 100 questionnaires handed out. According to Mugenda and Mugenda (2003) and also Kothari (2004) a response rate of 50 % or more is ideal for data analysis. Babbie (2004) also asserted that return rate of 50% is acceptable to analyze and publish, 60% is good and 70% is very good. Based on these assertions from renowned scholars 76% response rate is adequate for the study.

The study findings indicated that majority of the respondents were male (70%) followed by female (30%). The study also illustrated that 42% of the respondents were aged between 36 and 50 years while 26.3% were aged between 20-35 years, 17% of the respondents were between 51-60 years and finally 14% of the respondents were aged between 18-20 years. The results showed that 39.6% of the respondents were supervisory
level while 31% were in middle management and 28.9% were in top management. The study findings also revealed that majority that 36% of the respondents had attained college level, 33% had reached university level, 21% has attained post graduate level and 10% had attained secondary level and 39% of the respondents indicated they had worked for 6-8 years, 34% had worked between 8-10 years, 15% indicated between 3to 5years and 12% had over 10 years.

The first objective of the study was to investigate the influence of corporate governance on financial performance of the SMEs, Results indicated that majority of the respondents agreed that corporate governance influences the financial performance positively. This was evidenced by the responses from the respondents who agreed to the statements on such as the CEO’s role in our firm is separated from the chairman’s role, audit committee focus on improving the company performance and competitiveness, the composition of the board of our firm is a balance of executive and non-executive directors of diverse skills or expertise, the effective use of committees improve the quality and efficiency of the board responsibilities and mandates are clearly defined and Corporate governance has stipulated proper book keeping and ensures that the financial accounts and books are audited on a regular basis. The relationship between corporate governance and financial performance is positive and significant (r= 0.287, p=0.000). The findings imply that an increased level of corporate governance is associated with an increased financial performance.

The second objective was to determine the effect of human resource capacity on financial performance of SMEs. The study findings indicated that majority of the respondents agreed with the statements on human resource capacity on financial statements such as the HR departments ensures that employees are conversant with new trends in technology adopted in market, finance and accounting department are the most understaffed, accountants in most cases play roles of administration, human resources and even operations, the company has put in place staff training and development programs. The company has put in place staff training and development programs and well trained and experienced accountant help improve financial performance of the company. The relationship between human resource and financial performance is positive and significant (r= 0.611, p=0.000). The findings imply that an increased level of corporate governance is associated with an increased organizational performance.
The third objective of the study was to determine the influence of access to finance on financial performance of SMEs. Access to finances was found to be a key determinant factor of financial performance this was evident with the overwhelming responds from the respondents who agreed with the statements: Access to financing is important for growth of SMEs, bank loans are easily accessible and available for use to start up a business, total credit finance accessed through semiformal financial sectors has positively affected my business, most financial institutions are reluctant to provide long-term credit to SMEs and reduction on the cost of finance, that is interest rates, application fees, loan insurance premium, legal fees etc has made it easy for SMES to access finance The relationship between access to finance and financial performance is positive and significant (r= 0.329, p=0.000). This implies that an increased level of corporate governance is associated with an increased organizational performance.

5.3 Discussion of the Findings

5.3.1 Corporate Governance and Financial Performance

The first objective of the study was to investigate the influence of corporate governance on financial performance of the SMEs, results indicated that majority of the respondents agreed that corporate governance influences the financial performance positively. This was evidenced by the responses from the respondents who agreed to the statements on such as the CEO’s role in our firm is separated from the chairman’s role, audit committee focus on improving the company performance and competitiveness, the composition of the board of our firm is a balance of executive and non-executive directors of diverse skills or expertise, the effective use of committees improve the quality and efficiency of the board responsibilities and mandates are clearly defined and Corporate governance has stipulated proper book keeping and ensures that the financial accounts and books are audited on a regular basis. The relationship between corporate governance and financial performance is positive and significant (r= 0.491, p=0.000). The findings imply that an increased level of corporate governance is associated with an increased financial performance

Regression results indicated corporate governance affects financial performance positively and significantly, In particular, the results indicate that a unit increase in
The result findings also agreed with those of Claessens et al., (2002) noted that corporate governance does apply to SME’s and is indeed very acute amongst SME’s. According to the scholars, most SME’s are owned and managed by the owner as sole proprietors. This therefore does not create opportunities for separation of ownership and management in comparison to corporations and large firms. In addition, calls for corporate governance in SME’s is muted due to low number of employees in SME’s and most of whom are relatives or friends of the manager. Furthermore, most SME’s are not public entities and thus have no responsibility to the public as investors which reduces the calls for corporate governance amongst the SME’s. Due to this characteristics, it is very hard to find laws and regulations necessitating the SME’s to comply with disclosure regulations or strict regulations on the management and reporting of the firms. Consequently, there arises no agency problem, no need to maximize profit and market value due to the lack of investor concerns. Furthermore, no disagreements arise in most SME’s due to their nature of ownership which does not necessitate the need for corporate governance (Claessens et al., 2002).

The results also agreed with those of Guest (2009) examined the impact of corporate governance in SMEs in UK he assets that board size on firm performance for a large sample of 2,746 UK listed firms over 1981-2002. Secondary data on board size and financial performance was collected from “DataStream” and regression analysis used to analyze the data collected. They noted that the UK provided an interesting institutional setting, because UK boards play a weak monitoring role and therefore any negative effect of large board size is likely to reflect the malfunction of the board’s advisory rather than monitoring role. They found that board size has a strong negative impact on profitability, Tobin’s Q and share returns. They also found that the negative relation is strongest for large firms, which tended to have larger boards. Overall, their evidence supports the argument that problems of poor communication and decision-making undermine the effectiveness of large boards.

The study findings agree with those of According to Petra (2005), good corporate governance aims at increasing profitability and efficiency of organizations and their
enhanced ability to create wealth for shareholders, increased employment opportunities with better terms for workers and benefits to stakeholders. Indicators of Good Corporate Governance identified in the study include independent directors, independence of committees, board size, split chairman/CEO roles and the board meetings. Thus, the main tasks of corporate governance refer to: assuring corporate efficiency and mitigating arising conflicts providing for transparency and legitimacy of corporate activity, lowering risk for investments and providing high returns for investors and delivering framework for managerial accountability.

5.3.2 Human Resource Capacity and Financial Performance

The second objective was to determine the effect of human resource capacity on financial performance of SMEs. The study findings indicated that majority of the respondents agreed with the statements on human resource capacity on financial statements such as the HR departments ensures that employees are conversant with new trends in technology adopted in market, finance and accounting department are the most understaffed, accountants in most cases play roles of administration, human resources and even operations, the company has put in place staff training and development programs. As the business environment changes, there must be changes in the operational framework of SME’s for seamless transition of employees to suit changing customer needs and demographic characteristics. Furthermore, managers of SME’s must be receptive of business needs, environmental needs and business core competencies to enhance sustainability of SME’s in the long term. This can be achieved through human resource development. ON the other hand, the adoption of human resource development will lead to competitive advantages for the SME’s (Evans et al., 2002; Acs, 2004).

The company has put in place staff training and development programs and well trained and experienced accountant help improve financial performance of the company. The study findings agree with those of Cant and Lightelm (2003) who asserted that small business failure maintain that entrepreneurs often have good ideas and are competent but they do not have a clue on how to run a business and have no underlying appreciation of business fundamentals. Professionalism is one of the areas that have failed the SMEs firms. Most of these firms only have unskilled labour and a small percentage of skilled labour and this majorly affects aspects of entrepreneurial firms. Experience takes many guises and breadth of experience is shown to be an important factor driving the
performance of firms, with the number of previous jobs positively related to new firm performance (Lumpkin and Marvel, 2007).

The relationship between human resource and financial performance is positive and significant ($r= 0.414$, $p=0.000$). The findings imply that an increased human resource capacities is associated with an increased organizational performance. Regression results indicated human resource affects financial performance positively and significantly in particular, the results indicate that a unit increase in the human resource capacity would result to a 0.224 or rather it would lead to 22.4% increase in financial performance. Beaver (2002) and Beaver and Jennings (2001) noted that SME’s must also embrace diversity and flexibility in its human resources. SME’s just like large corporations are bound by legislations and laws that stipulate diversification of human resources and development of human resources. Therefore, SME’s must undertake corrective and affirmative actions to enhance human resource development and growth in the workplace. Findings agree with those of Ogolla (2001) the survival and success of any firm solely rely on its ability to integrate the right personnel at the right time and at the right place. Human resource management has been recognized by professionals as an important factor responsible for the competitiveness of firms and it assists firms to determine the key human resources management functional areas that is responsible for elevating the status of organizations. Acceptance and practices of human resources management in an organization result in a number of role changes and provide new challenges to the professionals in this discipline. That is, the more establish the strategic roles for HR functions, the more the expectation to partner with top management to achieve business success.

5.3.3 Influence of Access to Finances on Financial Performance

The third objective of the study was to determine the influence of access to finance on financial performance of SMEs. Access to finances was found to be a key determinant factor of financial performance this was evident with the overwhelming responds from the respondents who agreed with the statements: Access to financing is important for growth of SMEs, bank loans are easily accessible and available for use to start up a business, total credit finance accessed through semiformal financial sectors has positively affected my business, most financial institutions are reluctant to provide long-term credit to SMEs and reduction on the cost of finance, that is interest rates, application fees, loan
insurance premium, legal fees etc has made it easy for SMES to access finance. The study findings are supported by most studies (Ngobo, 2006; Kibera and Kiberam, 2010; Chijoriga and Cassiman, 2016), which point to finance as one of the key constraints to small enterprise growth. This is worsened by the absence of financial markets in the developing countries. Small enterprise owners cannot easily access finance to expand business and they are usually faced with problems of collateral, feasibility studies and the unexplained bank charges. This means that they cannot access finance to enable them to grow. Ngobo (2006), makes a detailed analysis of finance as a constraining factor and includes collateral, interest rates, extra bank charges, inability to evaluate financial proposals and lack of financial management skills as hindrances to small enterprise growth. Under developed financial markets impose additional constraints. There are no financial instruments and no independent financial sources that are market driven.

The relationship between access to finance and financial performance is positive and significant ($r= 0.612$, $p=0.000$). These findings imply that an increase in access to finances is associated with an increased organizational performance. Regression results indicated access to finances affects financial performance positively and significantly in particular, the results indicate that a unit increase in the access to finances in SMEs result to 0.364 or rather it would lead to a 36.4% increase in financial performance. Kinyua (2014), researching on factors affecting the performance of small and medium enterprises in the Jua Kali Sector in Nakuru town, Kenya with objectives to investigate the role of finance, management skills, macro-environment factors and infrastructure on performance of small and medium-sized enterprises in the Jua Kali sector in Nakuru town. The findings indicated that; that access to finance had the potential to positively affect performance of SMEs.

The findings of the study agree with those of Macharia (2012) studied the effects of access to finance on micro and small enterprises investment growth in Ongata Rongai Township. The study found that in financing of the micro and small business, family and friends played a big role in helping the business owners boost their operations with an average of 40% of the finances coming from them, an average of 24% came from financial institutions while on average 30% of the finances were from business savings. The study also found that the main hindrance of SMEs in getting access to formal financial services due to lack of credit services awareness, lack of collateral, banks
vetting procedures, requirements of a guarantor, cost of loans and the employment as a security issue are some of the obstacles hindering utilization of the available credit facilities.

The findings of the study conquer with those of Harper and Soon, (2009) notes that businesses like grain millers and tailors are unable to compete with large manufactures of ready-made goods because they have to wait until a customer provides them with raw material or money to buy it. Some may be unable to get started until a customer pays the deposit, which will be used to buy the raw material. Access to finance is essential for improving SMEs competitiveness, as SMEs have to invest in new technologies, skills and innovation. Access to finance issues cannot be resolved by implementing financing schemes or programs in a vacuum. There are institutional issues covering a spectrum from the macro level to the micro, which are accompanied by capacity deficiencies.

5.4 Conclusions

5.4.1 Corporate Governance and Financial Performance

The study sought to determine the influence of corporate governance and financial performance. From the findings on the effects of corporate governance on the financial performance of SMEs in Nairobi County, the study found that most SMEs have common cases of CEO duality thus, in most cases, the manager is the same as the owner of the firm. This was however noted to still have a positive effect on the financial performance. It can also be concluded that the SMEs agree to the fact that there is need to separate the CEO and the manager in order to realize better financial performance through the decisions being made. Most of the SMEs however, have board of management to ensure proper decision and control of the firms’ affairs which has a strong positive correlation to the financial performance. Results also led to conclusion that the SMEs have embraced and put into practice the structures of corporate governance and it works for their good. Generally, it can also be concluded that the SMEs appreciate corporate governance practices and their role to enhance financial performance yet majority of have not been able to adopt the practices since most of them still consider the practices applicable to large and established companies. Those adopting the practices have not fully incorporated them citing their size, limited finances and rigid government regulations as their limitations.
5.4.2 Human Resource Capacity and Financial Performance

The second objective was to determine the effect of human resource capacity on financial performance of SMEs. The study clearly demonstrates the importance and the impact of human resource capacity on financial performance. SMEs have ensured that their workers are being trained well for the betterment of the firms. The study confirms the importance of human resources represent a very important factor in creating of competitive advantage of an organization. The study demonstrated that to achieve higher financial performance and competitive advantage, SMEs must pursue an aggressive management development through training, selection of the best employees and put in management strategies that responds quickly to the market changes. Human resources, drives competitive advantage as above-average quality of personnel structure and diversity of their professions, directly lead towards creation of services and products of superior values to consumers. This acts as a differentiator to an organization’s services.

5.4.3 Influence of Access to Finances and Financial Performance

The third objective of the study was to determine the influence of access to finance on financial performance of SMEs. The study came to a conclusion that access to finances is a key determinant of financial performance. Accessing bank loans easily has improved the financial status of SMEs reduction on the cost of finance that is interest rates, application fees, loan insurance premium, legal fees etc has made it easy for SMES to access finance.

5.5 Recommendations

5.5.1 Recommendations for Practice

5.5.1.1 Corporate Governance and Financial Performance

The study recommends that the government of Kenya be supportive to the SMEs by providing incentives to help them in implementing the corporate governance practices. SMEs are also encouraged to embrace corporate governance to the fullest to achieve better financial performance. SMEs are also recommended to consider financial monitoring to be done by the board of managers and board sub-committees. The board and managers also need to be enlightened on the importance of corporate governance
5.5.1.2 Human Resource Capacity and Financial Performance

The study recommends that SMEs should encourage, employees training, compensation, performance appraisal and employee participation which are significant components to SMEs performance. To enjoy the differentiating factor of unique human capital, the organizations should offer continuous human resources training and development to their staff members. Further, there is need for the organizations to put in systems that collects intrinsic cognitive knowledge from experienced staff. The information to which may be used to develop unique institutional memories through mentorship and other inherent knowledge management systems.

5.5.5.3 Influence of Access to Finances and Financial Performance

Small and micro enterprises play crucial role in an economy and are key source of economic growth, dynamism and flexibility and can adapt quickly to changing market demand and supply situations. They generate employment, help diversifying economic activity and make significant contribution to export trade. Therefore, measures to boost the financial performance of SMEs are important. According to the study findings, majority of SMEs in rely on financing from institution sector to which the finances from the source are limited. Hence, the study recommends formulation of measures to ensure to facilitate SMEs in financial access.

5.5.2 Recommendations for Further Studies

The study recommends that further research should be done on the effect of financial performance of big corporations since this study only dealt with small firms and therefore; the findings may not be applicable to big firms. Secondly, this study targeted SMEs from Nairobi only those are registered; the SMEs may not be representative of all SMEs in informal settlement or SMEs in Kenya. Hence, further study can be done but focusing on SMEs that are not registered.

Arising from the findings and the gaps in the study a replica study is recommended in another institution in order to test whether the conclusions of this study will hold true. Future studies should apply different research instruments like focus group discussions to involve respondents in discussions in order to generate detailed information which would help improve financial performance of firms.
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APPENDICES

APPENDIX I: LETTER OF INTRODUCTION

Dear Sir/Madam,

RE: RESEARCH STUDY

I am pleased to inform you that I am a student at United States International University pursuing a degree of Masters in Business Administration (MBA). As partial fulfillment for my degree, I am conducting research on factors affecting financial performance of small and medium enterprises in Kenya.

Kindly note that any information given by you will be confidential and will not be used for any other purpose other than this research project. Your contribution and assistance is really appreciated. I look forward to receiving your response.

Yours faithfully,

Fredrick Kangala Nakhaima

Mobile Number: 0720-756-938

Email: fnakhaima@gmail.com
APPENDIX II: QUESTIONNAIRE

SECTION A: BACKGROUND INFORMATION

1. Kindly indicate your gender
   Male
   Female

2. Age
   a) 18 – 20
   b) 20 – 35
   c) 36 – 50
   d) 51 – 60.

3. What is your position in your department?
   a) Top management
   b) Middle management
   c) Supervisory

4. Highest level of education attained?
   a) Secondary level
   b) College level
   c) University level
   d) Post graduate level

5. How old is the company?
   a) 3-5 years
   b) 6-8 years
   c) 8-10 years
   d) Over 10 years

6. What is the number of employees in the company?
   a) 1-5
   b) 6-15
   c) 16-40
   d) 41-80
**SECTION B: CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF SMES**

Indicate the extent to which you agree with the following statements by using a scale of 1 to 5 where 1 = strongly disagree and 5 = strongly agree

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 ) The CEO’s role in our firm is separated from the chairman’s role</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2) Audit committee focus on improving the company performance and competitiveness.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>3) The composition of the board of our firm is a balance of executive and non-executive directors of diverse skills or expertise.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>4) The effective use of committees improve the quality and efficiency of the board responsibilities and mandates are clearly defined</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>5) Corporate governance has stipulated proper book keeping and ensures that the financial accounts and books are audited on a regular basis.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

6) How do you think SMEs can successfully ensure good corporate governance is established to ensure sound financial performance?

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SECTION C: RELATIONSHIP BETWEEN HUMAN RESOURCES CAPACITY AND FINANCIAL PERFORMANCE OF SMEs.

Indicate the extent to which you agree with the following statements by using a scale of 1 to 5 where 1= strongly disagree and 5 = strongly agree.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) The HR departments ensures that employees are conversant with new trends in technology adopted in market</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2) Finance and accounting department are the most understaffed</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>3) Accountants will in most cases play roles of administration, human resources and even operations</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>4) The company has put in place staff training and development programs.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>5) The company hires best talent in the market and it has resources to retain them</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>6) Well trained and experienced accountant help improve financial performance of the company.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

7) What do you think are the other factors in the human resources department that affect financial performance of the organization?

.................................................................

SECTION D: FINANCIAL ACCESS AND FINANCIAL PERFORMANCE Indicate the extent to which you agree with the following statements by using a scale of 1 to 5 where 1= strongly disagree and 5 = strongly agree.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Access to financing is important for growth of SMEs.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2) Bank loans are easily accessible and available for use to start up a business</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>3) Total credit finance accessed through semiformal financial sectors has positively affected my business</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>4) Most financial institutions are reluctant to provide long-term credit to SMEs.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>5) Reduction on the cost of finance, that is interest rates, application fees, loan insurance premium, legal fees etc has made it easy for SMES to access financing</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>
SECTION E: FINANCIAL PERFORMANCE
Indicate the extent to which you agree with the following statements by using a scale of 1 to 5 where 1= strongly disagree and 5 = strongly agree.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) We have superior firm performance</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2) We have competitive advantage over our competitors</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>3) Our company is highly profitable as compared to our competitors</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>4) Information and communication skills are effectively affecting our business performance positively</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>5) The business has experienced an increase in total revenue over the last 2 years.</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>