

# **FINANCIAL MANAGEMENT PRACTICES AND FINANCIAL PERFORMANCE OF SELECTED SMALL AND MEDIUM ENTERPRISES IN MOMBASA COUNTY, KENYA**

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## **ABSTRACT**

Most business enterprise depends on financial management practices to be successful, it is an integral part of an organization concentrating on the controlling of affairs of any enterprise. Most Small and Medium Enterprises collapse because of lacks capacity to establish proper and comprehensive management of finance. Findings obtained from previous studies have been inconclusive. Effects of financial management practices on the financial performance of selected SMEs in the county of Mombasa, Kenya was the main objective of this study while the specific objectives were as follows; to determine the effects of financing practices, investments practices, and Liquidity practices on the financial performance of selected SMEs in Mombasa County, Kenya. The design of this study was Descriptive research while the population targeted for the research was 206 respondents from selected SMEs in Mombasa County. A sample of 62 respondents was chosen using stratified sampling method, out of which 60 filled and returned the questionnaire. . Multiple regression model was specifically used to

analyze the study-specific objectives and results summarized using frequency distribution tables, mean scores and standard deviations with the help of statistical package for social science (SPSS). All SMEs were found to have incorporated financial management practices in their operation. The study concludes that majority of SMEs financial performance are affected by financial management practices. The study recommended to entrepreneurs to give priority to financial management practices when coming up with operation strategies. It has also recommended to policy maker to initiate policies to alleviate existing SMEs so that new employment opportunities for its population through public awareness using the findings of this study to assist both the current and upcoming enterprises so that they can realize their full potential. Lastly it has recommended to researchers to carry out further study with the use of all unused variables.

**Keywords:** Small and Medium Enterprises Financial Management Practices, Financial Performance.

## **INTRODUCTION**

Under the existing elastic and complete business environment, there is urgent need to conceive new strategy for business, financial strategy and organization transformation to safeguard it survives in the market. SMEs lacks the financial management and accounting systems which deep-rooted organization have at their disposal and in addition they are also unable to employ highly skilled professionals who can manage their financial departments properly (Lasagni, 2012). The aspiration of this research was to scrutinize how financial

management practices affects financial performance of selected SMES in the County of Mombasa.

Financial management practices are sets of common standard operating techniques concerned with the financial practices of an organization and the tools that are involved in decision making. Financial management practice is the optimum utilization of funds so that objectives of an enterprise can be accomplished which is the major problem facing SMEs in Vietnam (Chung and Chuang, 2010). This is the same problem facing other SMEs worldwide (Amoako, 2012). Financial management practices by SMEs in Kumasi Metropolis, Ghana face unique challenges due to their small nature and unreliable cash flow (Siaw, 2014). Unresponsive financial management practices are the main reason why majority of business enterprise miscarries in Kenya (Kwame, 2010). SMEs operating under tea sector in Mombasa underperform financially due inadequate financial management practices (Kimunyi, 2016). Majority of those who ventures into SMEs sector do not consider financial matters crucial in their operation, mainly concerned with other functions such as human resource, sales, marketing and production neglecting financial management practices, which is a major component of businesses in any organization. This is common across the globe, for example in Britain, eighty-five SMEs close every day due poor financial performance (ILO, 2009) whereas in Nigeria, the SMEs have performed negatively as per stakeholders expectations (Osotimehin, 2012). 60% of enterprises in Kenya collapse within the first few months of existence (KNBS, 2017). These hitches have occasioned to loss of confidence in the sector. Complicating matters, Osotimehin (2012), reports existence of high correlation between poor financial performance by SMEs and poverty in Nigeria. SMEs in Mombasa County growth has been slowed down by lack of knowledge and an organized financial market for financing despite being an important player in Mombasa County's development (Hassan, 2016). Therefore, there was a need to use empirical data to determine how financial management practices affects selected SMEs performance financially.

### **Statement of the problem**

Lacks of capacity by SMEs to establish proper and comprehensive management of finance because of their nature and sizes leading to their collapse (Erambo, 2017). According KBS survey report of 2016, about 2.2 million SMEs has collapsed in the previous five years, meaning on average 400,000 SMEs collapses every year. In addition, Mulinge (2017), viewed that the main reason for their collapse is inadequate sound financial management practices. Data from department of industrialization and enterprise development, Mombasa County report of 2017 shows that more than 3500 SMEs fails in their third year of operation which make this study necessary. Proper monetary control practices are necessary for jobs creation, which will stimulate economic growth and living standards of households in Kenya. Several studies have been carried out to find out the effects that financial practices have on financial performance of SMEs in pharmaceutical sector but the results have not been conclusive beyond reasonable doubt. The research therefore was to bridge this gap in the study.

Abu (2019), investigated Financial Management Practices and performance of SMEs in pharmaceutical sector trading in Dkaka stock exchange. Njoroge (2015), emphasizes on how inventory management affects performance of SMEs hospitals in Kenya. M'nyiri (2018), studied how small and medium enterprises hospitals service delivery are influenced by financial management practices in Nakuru sub-county. Chakraborty (2020), focused on the health quality and performance of SMEs in South Carolina. Ikechuku (2018), focused on how pharmaceutical SMEs in Nigeria are affected by liquidity. Wawire (2019), looked at determinant of financial performance of pharmaceutical SMEs in Kenya. Mbothu (2009), focused on how returns of private hospitals in Nairobi are related with budgeting practices. Muthoni (2019), investigated how financing in health sector affects service delivery in Mombasa County. Onyango (2018), focused about the effects entrepreneurial impact on the performance of SMEs in the county of Mombasa.

Although studies have been conducted, pertaining management practice of finance in SMEs as shown above, the findings obtained have been inconclusive. The relationship between management practices of finance and financial performance of SMEs in pharmaceutical sector have not been well established beyond reasonable doubt. This made the study necessary to further assess the points of non-consensus on the relations between finance management practices and performance of SMEs financially. In addition to that, since time has elapsed, many things might have changed from when they were carried. This study aims was bridging the above highlighted knowledge gaps by attempting to address the issue of non-consensus, time lapse and location of study done in the SMEs sector.

### **Research Hypotheses**

- H01:** There is no effects of financing practices on the financial performance of selected SMEs in Mombasa County, Kenya
- H02:** There is no effects of the investment practices on the financial performance of selected SMEs in Mombasa County, Kenya?
- H03:** There is no effects of Liquidity practices on the financial performance of selected SMEs in Mombasa County, Kenya?

### **THEORETICAL REVIEW**

#### **Pecking order theory**

The theory was formulated by Myers in 1984. It is based on the assumption that investors lack inside information which managers enjoy. Since access to information is not uniform to all stakeholders, it is asymmetric and because of asymmetric information, when the future is bright managers will issue debt and when there are uncertainty managers will issue equity. A commitment to issue debt indicates steady cash flow which will be used to repay the debts while issue of ordinary shares shows an over value of share prices. According to Ran (2018), this theory suggests that managers always prefer to use finance available internally, but when

internal finances are not available, they prefer borrowing and as a last resort, manager's issue shares to raise finance.

### **Financial theory of investment**

This theory was formulated by Minsky in 1986. It links financial markets weakness, in the commercial cycle of the economy, with speculative investments in financial market. According to Pike (2019), this theory opines that, during peak period, company cash flow goes beyond what is necessary to repay debt and a hypothetical enthusiasm develops. Thereafter debt will be more than income of debt holder's income resulting into financial crisis in the economy. Due to this unintended borrowing, financial institutions begin to control credit facilities and therefore this theory advocates the use of borrowing to finance investments is determined by the business cycles.

### **Liquidity preference theory**

It was formulated by John Maynard Keynes in 1936. According to Brealey and Myers (2003), liquidity is the ease at which conversion of cash from assets or its equivalence at the pleasure of the owner. Cash is the most liquid asset. Liquidity can also be referred as the ability of current assets to match current liabilities and therefore a liquid enterprise has enough cash to meet its daily needs such payment of creditors, salary and other expenses.

The Liquidity Preference Theory says that desire to remain liquid is not the demand to borrow more money (Nyamao, L. O & O, 2012). Investors hold preference for short term securities because it is easy to change those securities into cash. On the other side borrowers prefer long term debts because this does not force them to the risk of paying debts under unfavorable conditions.

### **Portfolio Theory of expected Returns**

It was formulated by Harry Markowitz in 1952. There are systematic risks which is referred to as variations in returns due to factors that unfavorably affects all firms and such factors include; political instability, prices instability and fluctuating interest rates. At the same time unsystematic risks which have effects to specific firms such as court battles, workers unrest and marketing programs. Prospective Investors normally want to optimize their returns and reduce risk. This theory suggests that a portfolio will only be considered profitable if either it has high returns or low risk of exposure. This will enable businesses to reduce risks (Brealey and Myers, 2003).

### **Empirical Review**

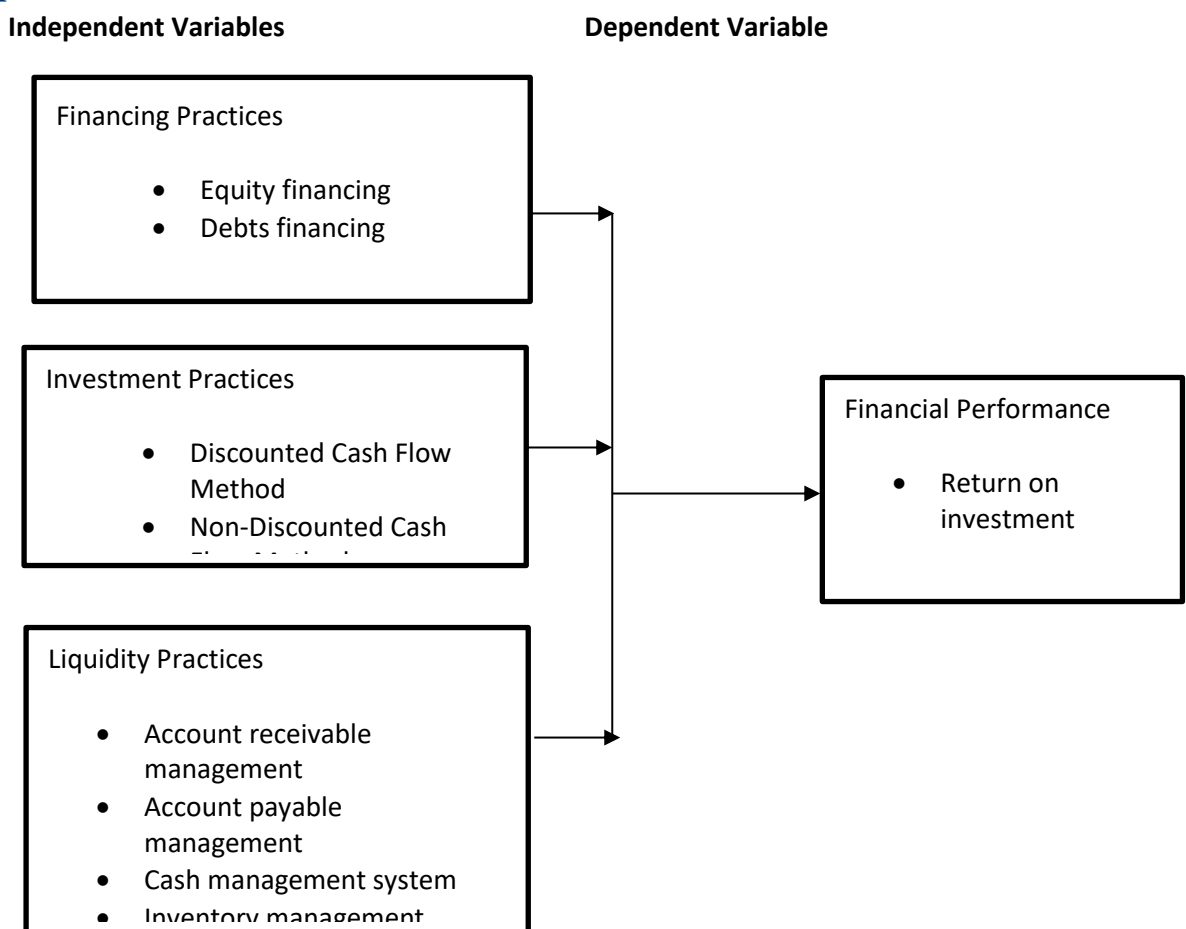
Njoki (2018), investigated the effects of financing decision on the performance of trading MSEs at the NSE financially and found out that capital structure of a company has relatively strong effect on the financial performance of SMEs trading at the NSE financially. Though

the finding did not clearly indicate the relationship between financing decision and financial performance of the firms which this study aims was to bridge.

Mumia (2014), did a study on the effects of project investment and source of finance on performance of the SMEs in sugar sector in Kenya financially and the realized that investment decision has positive effects on performance of sugar factories in Kenya financially. It recommends that sugar factories in Kenya should enhance investments in long term assets with the aims of spreading in other products line in order to grow in terms of income generation and to remain economically viable hence achieving high performance financially in the end. The relationship between investment decisions and financial performance was not well established since the findings dwelled on effects and also the study was conducted in sugar sector while this one will be conducted in health sector.

Ngeno (2018), carried out a study on the influence of WCM on the performance of SMEs financially in Nairobi, county and found out that WCM are significant determinant in SMEs in Nairobi County and contributes to outstanding outcome in the level of performance in terms of finance. This study concentrated on the influence and found out that liquidity contributes to financial performance but fails to determine the relationship between liquidity and financial performance which this study seeks to established.

### **Conceptual Framework**



**Fig 2.1: Conceptual Framework**  
Source: Researcher, 2022

## **RESEARCH METHODOLOGY**

The study generally used descriptive research design. The target population in this study consisted of 206 respondents from selected SMEs in Mombasa County operating in the pharmaceutical sector. Stratified sampling technique was utilized to collect data in this study. The target population was divided into three sub-groups since it is not homogenous. Pharmacies which has a target population of 94 formed the first sub group, clinics have a target population of 89 was second and cosmetics a target population of 23 was the third. The study utilized both primary and secondary data where primary data was collected through questionnaires. 6 respondents which is 10% of the sample was tested for questionnaire’s reliability and validity and based on the feedback of the pilot study, for internal consistency of the questionnaire, Cronbach Alpha was used. . For the analysis of data Statistical package for social sciences (SPSS) software was used. Average statistics such as frequencies, percentages and mean was used for representation for this study. The regression method was applied since data was collected using Likert Scale concerning the dependent variable and independent variable in the research.

## **RESULTS FROM STUDY FINDINGS**

### **Financing practices.**

The study found out that financing practices have effects on financial performance of SMEs. The finding on financing practices concurs with previous studies which have been conducted that financing practices have effects on financial performance of SMEs. Jumane (2015), carried out the research on the effects of financing decisions on the performance of SMEs financially in Tanzania. The outcome was that ordinary share capital and borrowing capital has notable effects on the performance of SMEs in Tanzania. Njoki (2018), investigated the effects of financing decision on the performance of trading MSEs at the NSE financially and found out that financing decision of a company has relatively strong effect on the financial performance of SMEs trading at the NSE financially.

### **Financing practices**

<b>Statement</b>	<b>Mean</b>	<b>N</b>	<b>Std, Dv</b>
Debt financing	4.4667	60	.50310
Equity financing	3.8833	60	1.15115
<b>Overall</b>	<b>4.3333</b>	<b>60</b>	<b>.57244</b>

**Source: Research data 2022**

### **Investment Practices**

The study found out that investment practices have effects on financial performance of SMEs. The finding on investment practices concurs with previous studies which have been conducted that financing practices have effects on financial performance of SMEs. Patrick (2018), carried out the research on the effects of investment appraisals on the performance of

SMEs financially in the Nairobi County and found out that many firms are affected by investment appraisal methods they deploy in their choosing investment projects. Tijani (2019), investigated the effects of investment appraisal techniques by SMEs operators in the Tamale metropolis, Ghana. He found out that SMEs financial performance in Tamale metropolis are affected by project investment appraisal methods they use in making decisions.

### **Investment practices**

<b>Statement</b>	<b>Mean</b>	<b>N</b>	<b>Std, Dv</b>
Discounted cash flow method	3.8500	60	1.21885
Non Discounted Cash flow Method	3.3667	60	1.36502
<b>Overall</b>	<b>3.6833</b>	<b>60</b>	<b>1.08130</b>

**Source: Research data, 2022**

### **Liquidity Practice.**

The study found out that liquidity practices have effects on financial performance of SMEs. The finding on liquidity practices concurs with previous studies which have been conducted. Ngeno (2018), carried out the research on the effects of liquidity decisions on the performance of SMEs financially in Nairobi County, Kenya. The outcome was that liquidity practices has notable effects on the performance of SMEs in the county of Nairobi financially. Raji (2017), examined the influence of liquidity practices on the performance of SMEs financially and found out that creditor’s period, cash conversion cycle and working capital cycle have positive effects on the performance on SMEs financially in Nigeria while account receivable.

### **Liquidity Practices**

<b>Statement</b>	<b>Mean</b>	<b>N</b>	<b>Std, Dv</b>
Account Receivable Management	4.5167	60	0.50394
Account Payable Management	4.4667	60	0.74712
Cash Management	4.6000	60	0.49403
Inventory Management	4.6500	60	0.57711
<b>Overall</b>	<b>4.5000</b>	<b>60</b>	<b>0.50422</b>

**Source: Research data, 2022**



### **Correlation Analysis**

Correlation Analysis was used to determine the relationship two or more set of variables. It gives direction of how much relationship exist between these variables. The study used person’s correlation. The table 4.21 gives different sets of variables received during study.

**Table 4.21 Correlation Analysis**

Control Variables		Financial Performance
	Correlation	.102
Financing Practices	Significance (2-Tailed)	.437
	Df	58
	Correlation	-.343
Investment Practices	Significance (2-Tailed)	.007
	Df	58
	Correlation	.075
Liquidity Practices	Significance (2-Tailed)	.571
	Df	58
	Correlation	1.000
Financial Performance		.

**Source: Research data, 2022**

Financing practices had a person correlation of 0.102 and P-value of 0.437, Investment practices had a person correlation of -0.343 and P- value of 0.007 while Liquidity practices had a person correlation of 0.075 and P- value of 0.571, meaning Financing practices and liquidity practices had positive effects on financial performance of SMEs, therefore an increase in these variables causes an increase in financial performance. On the other hand investment practices had negative effects on financial performance, meaning a growth in this variable causes a decline in financial performance of SMES. All the variable were significant except liquidity practices whose P- value was slightly more than 0.05. It means Financing Practices has positive and significance effects on financial performance. This concurs with previous studies which have been conducted.

Kinyua (2018), carried out the research on the effects of financing decisions on the performance of SMEs financially in Embu County, Kenya. The outcome was that ordinary share capital and borrowing capital has notable effects on the performance of SMEs in the county of Embu financially. Patrick (2018), investigated the project appraisal methods and performance of SMEs in Nairobi City County in terms of finance and found out that ARR, PP, NPV and IRR significantly impacts performance among SMEs in Nairobi County financially. Thomas (2016), scrutinized the influence of WCM practices on the performance of SMEs financially in Machakos Sub County, Kenya and found out that WCM practices are low among the SMEs and therefore was below average however it failed to comprehensively establish the relation that exists between liquidity and financial performance of SMEs.

### **Regression Analysis**

It was used to determine the relationship of the variables. The coefficient of correlation of 0.353 indicating positive correlation between independent variables and dependent variable. This agreed Mutie (2019) which found out that financial practices have positive correlation with financial performance. Coefficient of determination of 0.125 suggesting that the model justify for up to 12.5% of variations of financial performance of SMEs. 87.5% of the variation in the SMEs financial performance are accounted for by variables not present in the model.

### **Regression Analysis**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.353 <sup>a</sup>	.125	.078	.64935	2.126

**Source: Research data, 2022**

The ANOVA table provides the result from which generally usefulness of the regression model was evaluated. The F value is 2.665 which significantly greater than 1 which is unlikely to have happened by chance (P<0.050). The findings of this research confirms with that of Sekaran (2014) who stated that when F value is less than 1 then it means that the model does not accurately predict the result. It can be concluded that the model is better and more significant forecaster of the connection between financial management practices and financial performance of SMEs.

**TABLE 4.23 ANOVAa**

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	3.371	3	1.124	2.665	.050 <sup>b</sup>
Residual	23.612	56	.422		
Total	26.983	59			

**Source: Research data, 2022**

The model coefficient shown in table indicates that financing practices had a coefficient of 0.081, investment practices had a coefficient of -0.208 while liquidity practices had a coefficient of 0.065. This implies that financing practices and liquidity practices had positive effects on financial performance of SMEs while investment practices had negative effects on financial performance. The models were also significant at 95 % significant level as their P-values were less than 0.05. The constant was 3.604 while P was 0.01.

### **Conclusion**

The study concludes that all SMEs have in place the necessary financial management practices to enable them run their enterprises. Nevertheless different enterprises vary with the degree of adoption due to different financial structure. The results of the study showed that the majority of respondents agreed that with the fact that financing practice affects financial performance of SMEs. Financing practices had acceptance, which may be as a result of most

MSEs using them in their financial operations. Financing practices was further found to be having significant positive effects on SMEs financial performance. The study therefore concludes that financing practices affects financial performance of SMEs.

The results of the study showed that the majority of respondents agreed that with the fact that investment practice affects financial performance of SMEs. Although an increase in investment practices decreases financial performance. The correlation and regression analyses showed a negative correlation between investment practices and other independent variables as well as financial performance. The study concludes that investment practices decreases financial performance of SMEs.

The results of the study showed further that the all respondents agreed that with the fact that liquidity practice affects financial performance of SMEs. This showed that SMEs use liquidity practices in their financial operations. Liquidity was further found to positive but less significance effects on financial performance. The study concludes that liquidity practices have some effects on financial performance of SMEs. This was also established by Rathnasiri, (2015) who conducted study of SMEs in Sri Lanka.

Based on the findings of the study, the study further concludes that there is a positive relationship between the variable with coefficient of correlation of 0.353. The variable which are financial management practices are concluded to have significant effects on financial performance of SMEs hence integrating financial management practices will enhance financial performance.

Various studies conducted internationally have come up with similar conclusions. Abanis, (2013) investigated relationship between financial practices and financial performance in Uganda and found out positive relationship. Salah, (2015) conducted a study in Tamale metropolitan, Ghana and found out positive relationship. On the same line Mazzarol, (2015) the study about the effects of financial practices on financial performance of SMEs in Australia and Singapore and found out that financial practices improves financial performance of SMEs.

### **Recommendations of the study**

The section provides recommendations and further studies. Based on the study findings, the study makes the following recommendations. First the study have found out that financial management practices have a significantly positive effects on financial performance of SMEs, so entrepreneurs should give priority to financial management practices when coming up with operation strategies. This will improves financial operations and efficiency. In addition the entrepreneurs should analyze and evaluate the capital structure of SMEs to balance the effects of debt and equity financing.

The study also recommends to the County government to come up with appropriate policies to stabilize existing SMEs and to come up with new employment opportunity for its

population through public awareness using the findings of this study to assist both the current and upcoming enterprises so that they can realize their full potential.

The national government can also use this information to come up with sound financial plans for development and growth of SMEs in the country. This will improve the financial operations of SMEs.

Though the objective of the study have been accomplished, there are certain areas which requires further research. Firstly the study only concentrated on financing, investment and liquidity practices. The value of  $R^2$  (0.125) indicates the part of the dependent variable explained by the independent variables. In this case, the declared deviation is 12.5%. The remaining 87.5% include other variables that were not examined in this study. To enable comprehensive determination, the study recommends further study with the use of all remaining variables. In future more studies can be done to determine the variations from this study. Future studies can be done find out whether same challenges facing SMEs still persist as found in this study and propose further remedies. In addition, the research can be done to capture other countries and expand the scope to obtain a general and detailed results.

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