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Socio-Economic Determinants of Performance of Small and Medium Enterprises (SMEs) in Gilgil Town of Nakuru County, Kenya

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Abstract: *This study sought to establish the socio-economic determiners of performance of SMEs in Gilgil town of Nakuru County, Kenya. It adopted a survey research design involving SMEs in Gilgil town. Questionnaires were used as research instruments to gather information on variables of interest. The target population of the study included the 400 SMEs in Gilgil town registered with the County Council of Nakuru in the year 2012 and thereafter a sample size of 196 (49%) SMEs owners were systematically selected as respondents for the study. Data collected was coded and analyzed with the aid of Statistical Package for Social Sciences (SPSS) computer programme. Quantitative data was analyzed using descriptive statistics such as percentages and frequencies while the qualitative data derived from open-ended questions was analyzed according to themes based on the study objectives and research questions and there after inferences and conclusions were drawn. The study revealed that very few SMEs owners had obtained management training; most of them had only obtained secondary education; SMEs lacked access to financial resources and very few had integrated technology in their business operation. These shortcomings have adversely affected the performance of the SMEs in Gilgil town going by the low profits that they are making. The study recommended that the government through the ministry of trade facilitate management training of SMEs owners; government and local authorities encourage prospective SMEs proprietors with higher level of education like diplomas and degrees to venture into SMEs business; lending institutions in Gilgil town to revisit their lending policies so as to make their services and products accessible to SMEs; and government and development agencies facilitate SMEs to acquire appropriate technologies that will aid SMEs in their operations.*

I. Introduction

The definition of small and medium enterprises (SMEs) differs according to the study one is carrying out or the size of the economy being studied. Criterion used in a given country of study also differs, depending on the purpose of classifying the business into SMEs or large. A business in Europe could be described as big in Kenya (Storey and Stokes 1978) . (Ombok (1990) points out that the point under which an enterprise is deemed to be small and the way in which its size is measured has been a debatable subject for a long time. There is no general consensus as to the definition of what a small, medium or large business is. (Hah and Urat 1994) point out that in countries such as United States, Britain and Canada businesses are defined in terms of paid up capital and number of employees. But the most appropriate definition of SMEs for this particular research study is of (Belandress, 1987) who defines SMEs as manufacturing or non manufacturing service enterprises which the owner management is not necessarily actively engaged in production but perform the various task involved in the leadership without the help of a specialised staff.

There is growing recognition of the important role that SMEs play in economic development. They are often described as efficient and prolific job creators, the seeds of big businesses and the fuel of national economic engines. Kenya with now an estimated population of almost 40 million people is still rated among the poor countries in the world. The country's development challenge remains in finding sustainable poverty eradication strategies and the SMEs have been identified as one of the strategies that can bring faster development and accelerate the employment creation (Government of Kenya (GOK), 2006).

Despite the potential role of SMEs to accelerated growth and job creation in developing countries, a number of bottlenecks affect their ability to realize their full potential. SME development is hampered by a number of factors, including finance, lack of managerial skills, equipment and technology, regulatory issues, and access to international markets (Gockel and Akoena, 2002).

The lack of managerial know-how places significant constraints on SME development. Euro Journals Publishing (EJP) (2010) observes that even though SMEs tend to attract motivated managers, they can hardly compete with larger firms. The scarcity of management talent, prevalent in most countries in the region, has a magnified impact on SMEs. The lack of support services or their relatively higher unit cost can hamper SMEs' efforts to improve their management, because consulting firms are often not equipped with appropriate cost-effective management solutions for SMEs. Besides, despite the numerous institutions providing training and advisory services, there is still a skills gap in the SME sector as a whole (Kayanula and Quartey, 2000). This is because entrepreneurs cannot afford the high cost of training and advisory services while others do not see the need to upgrade their skills due to complacency.

In terms of technology, SMEs often have difficulties in gaining access to appropriate technologies and information on available techniques (EJP, 2010). In most cases, SMEs utilize foreign technology with a scarce percentage of shared ownership or leasing. They usually acquire foreign licenses, because local patents are difficult to obtain.

EJP (2010) continue to posit that regulatory constraints also pose serious challenges to SME development and although wide ranging structural reforms have led to some improvements, prospects for enterprise development remain to be addressed at the firm-level. The high start-up costs for firms, including licensing and registration requirements, can impose excessive and unnecessary burdens on SMEs. For instance, the World Bank Doing Business Report (2006) indicated that it takes 127 days to deal with licensing issues and there are 16 procedures involved in licensing a business in Ghana. In addition, Ibid notes that it takes longer (176 days) in South Africa and there were 18 procedures involved in dealing with licensing issues.

Previously insulated from international competition, many SMEs are now faced with greater external competition and the need to expand market share. However, their limited international marketing experience, poor quality control and product standardization, and little access to international partners, continue to impede SMEs' expansion into international markets. They also lack the necessary information about foreign markets (EJP, 2010).

Most importantly, the lack of adequate financial resources places significant constraints on SME development. Cook and Nixson (2000) observe that, notwithstanding the recognition of the role of SMEs in the development process in many developing countries, SMEs development is always constrained by the limited availability of financial resources to meet a variety of operational and investment needs. For instance, Wanjohi (2009) posits that lack of access to credit is almost universally indicated as a key problem for SMEs. This affects technology choice by limiting the number of alternatives that can be considered. Many SMEs may use an 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. Wanjohi continue to note that credit constraints operate in variety of ways in a country like 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.

According to Wanjohi and Mugure (2008), Kenya has an estimated 1,300,000 SMEs; increasing at a rate of about 300,000 per year. Only about 50% are considered to be operating successfully; with the other half staggering towards closing down due to numerous challenges namely: Lack of Managerial Training and Experience, Inadequate Education and Skills, Lack of Credit, National Policy and Regulatory Environment, Technological Change, Poor Infrastructure and Scanty Markets information.

The number of small businesses is growing rapidly in Kenya as evidenced by the growth in the small business activities in the country (Sessional Paper, 2005). Every industry or sector of operation has smaller operations. These include textile industry, manufacturing, finance, security, food and hotels, transport, service sector to mention a few. The business environment is highly turbulent characterized by external factors (political/legal, economic/demographic, socio-cultural, technological and globalization) as well as internal business factors (management expertise, resources, individual characteristics, etc). In the dynamism and turbulence, small businesses are affected more than the large organizations because the response to environmental changes in small businesses is different from that of large companies (Hartshon & Wheeler, 2003: 203-320). A large company can move from one business to another and have resources and strategic choices not available to small business enterprises.

According to the 2006 Economic Survey, employment within the Sector accounted for 74.2 % of the total persons in employment. Also along with the overall policies and strategies of economic development especially with the adoption of a free market economic policy since 1991, small enterprise and business development has been recognized as a key element to promote the development of the country. The sector contributes up to 18.4 % of the country's Gross Domestic Product (GOK, 2006). The sector is, therefore, not only a provider of goods and services but also a driver in promoting competition and innovation, and enhancing the enterprise culture which is necessary for private sector development and industrialization in Kenya. It is expected that by the year 2030, Kenya will be transformed into a newly industrialized nation. If the country has to make this leap, then the small enterprises are expected to play a key role in this transformation. To play this role, the small enterprises must succeed and the failure rate characterizing the sector be minimized if not eliminated.

The current study therefore sought to determine the critical socio-economic factors affecting performance of SMEs in Gilgil town and assess possible strategies that can address some of the common factors impending the development, growth and profitability of the SMEs in the town. The town is approximately 25 Kilometres from Nakuru town and was initially in the larger Nakuru district before the split in 2009. Lowe (2007) had noted that Nakuru town, which was the main town of the larger district before the split, had an unprecedented proliferation of informal income-generating activities, which, despite offering great opportunity for employment, were faced with major difficulties that included: Lack of access to sources of capital; prohibitive business regulations; lack of effective marketing strategies and inadequate business management skills. The study assumed that these characteristics of the mother district were shared among the split districts that latter included Gilgil, Naivasha, Nakuru North, Rongai, Njoro and Molo.

Statement of the Problem

SMEs are of great importance to the Kenyan economy as they provide the much needed employment opportunities to a big number of its population who join the unemployment bracket every year. Besides SMEs form the base towards industrialization through growth and diversification of the enterprises over time. They take part in the wealth creation which ultimately raises the standard of living of the urban community. They also contribute to the Kenya's Gross Domestic Product thus boosting economic growth. However, despite the potential role of SMEs to accelerated growth and job creation in developing countries, studies have indicated that SME development, growth and profitability is hampered by a number of varied factors, including lack of adequate financing, lack of managerial skills, equipment and technology, regulatory issues, access to international markets, inadequate education and skills, poor infrastructure and scanty markets information (Wanjohi & Mugure 2008). Although a number of these researches have dwelt considerably on factors that contribute to success or failure of SMEs in general, none had focused on the exclusive socio-economic determiners of performance of SMEs in Gilgil town of Nakuru County, Kenya. This study therefore sought to determine the critical socio-economic factors affecting the performance of SMEs in Gilgil town and assess possible strategies that could address some of the common factors impending the performance of the SMEs in this town.

Objectives

i. To investigate the extent at which managerial training and experience influence performance of SMEs in Gilgil town
ii. To determine the extent at which education and skills among the proprietors influence performance of SMEs in Gilgil town
iii. To find out the extent at which access to financial resources influence performance of SMEs in Gilgil town.
iv. To assess the extent at which appropriate technological adoption influence performance of SMEs in Gilgil town

II. Literature Review

This chapter reviews literature related to the study. It contains discussion and comparison of the findings from researchers who have done their work in the field of SMEs. It is arranged according to the following topics: Lack of managerial training and experience; education and skills; lack of adequate financial resources; technological change; Characteristics of SMEs in Developing Countries; and conceptual framework of the study; Lastly, a summary of the literature review is given.

Influence of Managerial Training and Experience on Performance of Enterprises

It is believed that management is an important activity that helps organizations achieve or pursue their goals and hence management actions are very important (Gunningham, Thornton & Kagan 2005:289-316). Indeed, managers and management are essential in our modern business organisations and society (Hendricks & Singhal, 2001: 269-285). The activities undertaken in management, determine whether the business performs or does not perform well. For example, if a company or organization is in financial difficulty, then cost cutting may be inevitable (Nickels, McHugh & McHugh 2007:239). The way management tackles problems determines the long-term outcome of an organization (Balfanz & Koelmel, 2009).

Many SMEs owners or managers lack managerial training and experience. The typical owner or managers of small businesses develop their own approach to management, through a process of trial and error. As a result, their management style is likely to be more intuitive than analytical, more concerned with day-to-day operations than long-term issues, and more opportunistic than strategic in its concept (Hill 1987). Wanjohi (2009) opines that although this attitude is the key strength at the start-up stage of the enterprise because it provides the creativity needed, it may present problems when complex decisions have to be made. A

consequence of poor managerial ability is that SME owners are ill prepared to face changes in the business environment and to plan appropriate changes in technology.
King and McGrath (2002) adds that majority of those who run SMEs are ordinary lot whose educational background is lacking, hence they may not be well equipped to carry out managerial routines for their enterprises.

Influence of Education and Skills on Performance of Enterprises

Education and skills are needed to run micro and small enterprises. King and McGrath (2002) observe that those with more education and training are more likely to be successful in the SME sector. Ibid continue to explain that those entrepreneurs with larger stocks of human capital, in terms of education and (or) vocational training, are better placed to adapt their enterprises to constantly changing business environments. According to Wanjohi (2009) 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. As such, people need to be well informed in terms of skills and management for small businesses to do well in Kenya. This notwithstanding, SMEs in ICT sector 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 and Mugure, 2008).

Influence of Financial Resources Availabilty on Performance of Enterprises

Lack of adequate financial resources places significant constraints on SME development. Cook and Nixson (2000) observe that, notwithstanding the recognition of the role of SMEs in the development process in many developing countries, SMEs development is always constrained by the limited availability of financial resources to meet a variety of operational and investment needs. A World Bank study found that about 90% of small enterprises surveyed stated that credit was a major constraint to new investment (Parker et al., 1995). Levy (1993) also found that there is limited access to financial resources available to smaller enterprises compared to larger organizations and the consequences for their growth and development. The role of finance has been viewed as a critical element for the development of SMEs (Cook and Nixson, 2000).

Access to financial services by SMEs is normally seen as one of the constraints limiting their benefits from credit facilities. However, in most cases the access problem, especially among formal financial institutions, is one created by the institutions mainly through their lending policies. This is displayed in the form of prescribed minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes (Schmidt and Kropp, 1987).

For small-scale enterprises, reliable access to short term and small amounts of credit is more valuable, and emphasizing it may be more appropriate in credit programmes aimed at such enterprises. Schmidt and Kropp (1987) further argue that the type of financial institution and its policy will often determine the access problem. Where credit duration, terms of payment, required security and the provision of supplementary services do not fit the needs of the target group, potential borrowers will not apply for credit even where it exists and when they do, they will be denied access.

The Grameen Bank experience shows that most of the conditions imposed by formal credit institutions like collateral requirements should not actually stand in the way of smallholders and the poor in obtaining credit. The poor can use the loans and repay if effective procedures for disbursement, supervision and repayment have been established (Hossain, 1988).

On the issue of interest rates, the bank also supports the view that high interest rate credit can help to keep away the influential non-target group from a targeted credit programme (Hossain, 1988). This further demonstrates the need to develop appropriate institutions for the delivery of loans to small-scale borrowers.

Notable disadvantages of the formal financial institutions are their restriction of credit to specific activities, making it difficult to compensate for losses through other forms of enterprises, and their use of traditional collateral like land. There is need for a broad concept of SMEs finance to encompass the financial decisions and options of small businesses economic units, to consider the kind of financial services needed by these business holds, and which institutions are best suited to provide them.

According to Wanjohi (2009) lack of access to credit is almost universally indicated as a key problem for SMEs. This affects technology choice by limiting the number of alternatives that can be considered. Many SMEs may use an 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.

Wanjohi continue to note that 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. The other financial challenges that face small enterprises include the high cost of credit, high bank charges and fees.

Influence of Technological Adoption on Performance of Enterprises

Change of technology has posed a great challenge to small businesses. Wanjohi (2009) observes that since the mid-1990s there has been a growing concern about the impact of technological change on the work of micro and small enterprises. Even with change in technology, many small business entrepreneurs appear to be unfamiliar with new technologies. Those who seem to be well positioned, are most often unaware of this technology and if they know, it is not either locally available or not affordable or not situated to local conditions. Foreign firms still remain in the forefront in accessing the new technologies.

In most of the African nations, Kenya inclusive, the challenge of connecting indigenous small enterprises with foreign investors and speeding up technological upgrading still persists (Muteti, 2005). There is a digital divide between the rural and urban Kenya. With no power supply in most of the rural areas, it is next to impossible to have Internet connectivity and access to information and networks that are core in any enterprise. Thus technological change, though meant to bring about economic change even among the rural lot, does not appear to answer to the plight of the rural entrepreneurs and may end up creating further divide between the rural and urban locations.

Research Methodology

The study adopted a descriptive survey design involving SMEs in Gilgil town. Questionnaires were used as research instruments to gather information on variables of interest. The target population of the study included the 400 SMEs in Gilgil town registered with the County Council of Nakuru in the year 2012 and thereafter a sample size of 196 (49%) SMEs owners were systematically selected as respondents for the study. Data collected was coded and analyzed with the aid of Statistical Package for Social Sciences (SPSS) computer programme. Quantitative data was analyzed using descriptive statistics such as percentages and frequencies while the qualitative data derived from open-ended questions was analyzed according to themes based on the study objectives and research questions and there after inferences and conclusions were drawn.

III. Summary, Conclusion And Recommendations

Summary of the Findings

Firstly, the demographic data revealed that many (38%) of the SMEs sampled were run by youth aged between the age group of 20-30 years old; more males (71.9%) than females (28.1%) were involved in running of the SMEs in the town; and many SMEs (33.2%) in the town only made an average profit of below Kshs. 30, 000 per year.

Secondly, only 31.6% of the sampled respondents said that they had received some form of training in business management. More 26 (39.4%) of the respondents who have obtained some form of training in business management than 45 (34.6%) who had not were in the category whose businesses had achieved a profit margin of Kshs. 100,000 and above thus showing that the training has a positive influence on the performance of SMEs in Gilgil town. This finding was supported by many (43.9%) of the respondents who said that they believed that Management training influences performance of SMEs in a large extent.

In addition, respondents with experience of above three years were more 47 (49.5%) in the category of those who made a profit margin of above Kshs. 100,000 while those with one year of experience were only 6 (18.2%) in this category. This finding revealed that experience in business management positively influences the performance of SMEs in Gilgil town. The finding was supported by most (56.6%) of respondents who said they believed that length in business management influences business performance in a large extent.

Thirdly, most (59.7%) of the respondents reported that their highest level of education was KCSE followed by 27.6% who said that they had a college diploma. Most 11 (84.6%) of respondents with degree level of education had steered their businesses to achieve a profit margin of above Kshs. 100,000 in 2011 while only 2 (15.4%) with primary education were able to achieve this margin. This finding revealed that educational level of the SMEs proprietors has some influence on the performance of SMEs in Gilgil town. The finding was supported by many (39.8%) of the respondents who said they believed that the proprietors level of education influences business performance in a large extent.

Fourthly, only (30.1%) of the respondents said they had ready access to financial resources. More 27 (45.8%) of those who had access to financial resources had achieved a profit margin of above Kshs. 100, 000 in 2011 while only 39 (29.5%) of those who had no access to financial resources had been able to achieve this margin thus revealing that access to financial resources has a positive influence on the performance of SMEs in Gilgil town. This finding was supported by most (53.6%) of the respondents who said they believed that access to financial resources influences business performance in a large extent.

Fifthly, most (54.6%) of the respondents said they had adopted some technologies to aid them in their business operations. A large number 36 (89.7%) of those who had adopted some form of technologies had steered their businesses to achieve a profit margin of above Kshs. 100,000 in 2011 while only 31 (38.8%) of those who had not adopted any technology had been able to achieve this profit margin. This showed that the adoption of appropriate technologies has a positive influence on business performance in Gilgil town. The finding was supported by most (65.8%) of respondents who said they believed that adoption of technology influences business performance at a large and very large extent.

Conclusion

1. Only about a quarter of SMEs proprietors in Gilgil town have received some form of training in business management even though the study revealed that the training have positive influence on performance of SMEs.
2. Most of the SMEs proprietors in Gilgil town have KCSE as their highest level of education despite the fact that it was clear from the study that higher levels of education had positive influence on SMEs performance.
3. Although access to financial resources was seen to influence performance of SME in a positive way, only about a quarter of the SMEs owners in Gilgil town have ready access to financial resources.
4. Only about a quarter of SMEs are using appropriate technologies like computers, Internet and automatic machines to aid in their business operations despite the fact that the technologies were shown to have positive influence on SMEs performance.

This study therefore concluded that the above shortcomings that relate to lack of management training and experience; lack of education and skills; lack of access to financial resources; and lack of adoption to appropriate technologies have adversely affected the performance of the SMEs in Gilgil town going by the low profits that they are making.

Recommendations

1. The government through the ministry of trade should facilitate management training of SMEs owners in Gilgil town. This will help create SMEs managers who are analytical, more concerned with long-term issues of their businesses and ones who would be ready to embrace strategic planning in the business concepts.
2. The government and local authorities in Gilgil town should encourage prospective SMEs proprietors with higher level of education like diplomas and degrees to venture into SMEs business. Research has shown that those entrepreneurs with larger stocks of human capital, in terms of education and (or) vocational training, are better placed to adapt their enterprises to constantly changing business environments.
3. The lending institutions in Gilgil town should revisit their lending policies so as to make their services and products accessible to SMEs. Research has shown that in most cases the access problem, especially among formal financial institutions, is one created by the institutions mainly through their lending policies.
4. Government and development agencies should facilitate SMEs in Gilgil town to acquire appropriate technologies that will aid SMEs in their operations. It has been established that technologies can enhance the efficiency and effectiveness of business processes per se and in an absolute sense (e.g., regarding the cost and/or quality of processes before and after using the technologies.

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