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Effect Of Financial Risks On Performance Of Small And Medium Enterprises In The Hotel Industry In Nakuru Municipality, Kenya

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Abstract:
This study sought to determine the effect of financial risks on the performance SMEs in the hotel industry in Nakuru, Kenya. The specific objectives included to: Characterize financial risks in the hotel industry and determine the effect of financial risks: cash flow, credit and profit risks on performance of hotels within Nakuru Municipality. The study employed causal survey research design. The study examined 36 SME hotels within Nakuru Municipality. To achieve the objective of the study, primary data were collected using structured questionnaires. The collected data was analysed using descriptive statistics: frequency distributions and means with the help of SPSS computer programme. Pearson correlation analysis was used to determine the relation between the variables. The study findings revealed that: Businesses in the hotel industry were yet to employ increased credit sales and still experienced bad debts; The percentage profits by hotels in the study area increased steadily over the period 2009-2011; The capacity of the existing hotels in the study area has not increased to meet the increasing demand for hospitality services while revenue from accommodation has reduced during the period 2009-2011.Generally, financial risks negatively and significantly, influenced performance of small and medium hotels. The risks with a high effect include credit and cash flow risks which were found to negatively and significantly influence revenues from food and accommodation. The study therefore concludes that finance risks have had a significant effect on revenue and profitability of small and medium hotels in Nakuru Municipality. The study recommended the following measures: embrace cash sales and adopt effective measures for reducing the bad debts in order to attain increased revenues. The study also advises putting in place measures to minimize the effect of the financial risks on performance of hotels especially revenue from food and accommodation while addressing other factors that affect performance of the businesses.

Key words: *Financial Risks, Performance, Micro and Small Enterprise*

1.Introduction

1.1.Background Of The Study

According to Longenecker et al., (2006), financial risk management in any organization is very important as those risks affect the organizations' performance in many ways. For example, according to Marriot (2011), financial risks have a significant negative impact on shareholder value in an organization. In addition to the loss of investor confidence evidenced by an associated share price decline, an organization may face a drop in credit ratings, and management changes may be effected.

Watson (2001) contends that unforeseen volatility in financial markets creates havoc for chief risk officers, treasurers and chief financial officers. Organizations in all sectors have been buffeted by a significant slowdown in demand and the unprecedented levels of volatility in the financial markets. These risks include a potential upturn in inflation, with higher interest rates, underperforming pension assets, declining revenues and deteriorating credit quality of buyers and suppliers. Watson (2001) contends that any of these risks could threaten the organization's ability to fund necessary expenses such as debt service and pension obligations.

On profit risks and performance of organizations, Marriot (2011) notes that one of the most important ways that organizations measure their performance is in terms of their profit. In a competitive marketplace, profits result when an organization is efficient in providing products that customers want at a price they are willing to pay. Merit (2011) argues that organization's profit affect employee motivation and thus performance. He contends that profits can soar very high or very low. The result is a great deal of uncertainty about the amount of incentive pay each employee would receive in each period.

According to Chittenden and Bragg (1997) in a study on the link between profits and organizational performance that involved hundreds of global businesses, it was found that companies ranking in the top quartile were more than twice as likely to have above-average margins for their industry as measured by earnings before interest, taxes, depreciations and amortization. Other metrics included ration of net income to sales and growth in enterprise value. The research reinforced that enterprises that were ranked in the top quartile were the ones that had a stronger financial risk management system and were able to cushion themselves against anticipated profit risks.

In a study on measuring organizational performance, Davidson et al., (2004) observed that performance of an organization is often affected by the firm's cash flow. Financial risks are derived form the variability of the firm's cash flows and the firm's debt-to-equity ratio. Thus, the greater the variance in a firm's cash flow, the greater the share owners risk associated with larger amounts of debt. As a result, organizations with lower cash flow uncertainties tend to have much higher debt-to-equity ratios and accordingly, lower cost of capital than organizations with greater cash flows.

No doubt, any business entity needs robust risk management systems but the Small and Medium Enterprises (SMEs) need much more than that as they may not have wherewithal to manage and control risks due to their very size and several limitations. This is not true in the case of large corporate entities where professional personnel take care of many aspects pertaining to risk. All risk taking units must operate within approved procedures, limits and controls. There is no specific definition for SMEs, which normally cover closely held or unlisted companies, partnership firms, proprietor concerns, etc. There exists fundamental difference between the way they function and the way they will be served in the financial market, as the character and integrity of the promoter/ owner are the key and critical credit indicator and hence play a large role. In SME business, the 'gut feeling', which is subjective, is more relied upon than the 'pure analysis' that are more objective-oriented. Hence, both the business and professional relationships are rolled into one (Gibson, 2001).

From a credit risk point of view, SMEs are different from large corporates for many reasons. For example, De Vries (2004) analyzes a set of German and French SMEs and concludes that they are riskier but have a lower asset correlation with each other than large businesses. Indeed, it is hypothesized that applying a default prediction model developed on large corporate data to SMEs could result in lower prediction power and likely a poorer performance of the entire corporate portfolio than with separate models for SMEs and large corporate.

According to Amyx (2005), one of the most significant challenges affecting performance of SMEs in general in Kenya is the negative perception towards SMEs. Potential clients perceive SMEs as lacking the ability to provide quality services and are unable to satisfy more than one critical project simultaneously. Often, large companies selected and given business for their clout in the industry and name recognition alone.

Longenecker (2006) observes that in Kenya, most SMEs provide poor quality due to poor management characterized by lack of planning and poor financing. Oketch (2006) also identifies lack of credit as a serious constraint affecting SMEs. In a past study, Bowen et al. (2009) observed financial risks were also major factors affecting performance of SMEs in Kenya but the subject had not been dwelt on.

In addition, the researcher observes that there is very limited information on SME hotels in Kenya. In Nakuru, for example, the only information on SME hotels is the statistics available at the Municipal Council offices on the number of SME hotels which include 214 SME hotels and restaurants (Large-High standard hotels, Medium-High standard Hotels and Small-High standard Hotels). This study, therefore, aims to carry out the present study, to not only document information of SME hotels but also the financial risks that they face and how these risks affect their performance.

1.2.Statement Of The Problem

Small and medium-sized enterprises (SMEs) are seen as a key to economic growth, innovation and employment due to their significant employment potential, revenue generation and technological advancement in most advanced economies (Schlogl, 2004). In Kenya, the SME sector contributed over 50percent of new jobs created in 2005 (Economic Survey, 2006). However, despite their importance, research indicates that three out of every five enterprises established at a certain period of time often fail within the first three years of operation (Voerman, 2009). Though there are many factors that have been attributed to the poor performance and subsequent failure of SMEs. Mastura et al., (2010) says most of the enterprises perform poorly due to the financial risks they are exposed to.

The world over, many authors have identified several financial risks SMEs face, for example, Vandenberg (2008) identified that credit risk was a major financial risk facing hotel entrepreneurs in Latin America, EIM (2010) identified profit risks as a key determinant of SMEs success in Europe while Fisher (2011) identified cash flow risks as an impediment to performance in most SMEs. In Kenya, lack of credit has been identified as a key constraint facing SMEs and hindering their development (Oketch, 2000). Most of the studies carried out on SMEs in Kenya are focused on the challenges facing SMEs rather than risk perspectives (Wignara, 2003). The researcher also notes that very scanty studies have been carried out to bring out the financial risks facing SME hotels in Kenya and their effect on performance despite the financial risks being established, especially in developed countries, as having a direct influence on the performance of SMEs in general and those in the hotel industry.

In Nakuru, a town that is strategically placed to benefit from tourism, due to its magnificent sceneries like Lake Nakuru, Hyrax hills, Lake Elementaita and Menengai crater; hotel business is a key income earner. It is observed that the town has only 36 three and four star hotels (Nakuru Municipal Council office, 2012). Therefore, there is a need to fill in knowledge gaps by establishing whether financial risks affect the performance of SME hotels in Nakuru with a view to recommend the possible remedies in order to ensure that entrepreneurs are encouraged to venture more into this business thus maximizing the benefits associated with the tourism sector in the region. The study therefore investigated the effects of financial risks on the performance of small and medium hotels in Nakuru Municipality.

1.3.Objectives Of The Study

- To determine the effect of cash flow risks on performance of hotels within Nakuru Municipality.
- To establish the effect of credit risk of performance of hotels within Nakuru Municipality.
- To assess the effect of profit risk on performance of hotels within Nakuru Municipality.

1.4.Research Hypotheses

The study sought to verify the following hypotheses:

- H_{01}: Cash flow risks do not affect performance of hotels within Nakuru Municipality significantly.
- H_{02}: Credit risks do not significantly affect performance of small and medium hotels in Nakuru Municipality.
- H_{03}: Profit risks do not affect performance of hotels within Nakuru Municipality significantly.

1.5.Significance Of The Study

The study results documented the effects of financial risks on performance of SMEs in the hotel industry in Nakuru, Kenya. This provides a source of information to enrich literature and stimulate further research. Also it becomes handy in utilization by the tourism sector which deals with issues regarding to the hotel industry, and all other stakeholders involved in entrepreneurship in the hotel industry. The study findings also provide the policy makers in the government of Kenya with insights on the critical factors they need to be considered when formulating policies meant to enhance performance of SMEs in the hotel industry. This study is important as it sheds light as to why small and medium enterprises in the hotel industry within Nakuru have a hard time in remaining operational over time. The results are thus be relevant to practitioners in the hotel industry, especially those in the small and medium sector. Other entrepreneurs may also benefit from knowledge on the financial investment risks affecting their businesses. The study results provide information on further research for students, lecturers interested in this area of study.

2.Literature Review

In a study carried out though survey in 19 Latin America and Caribbean countries, Vandenberg (2008) found that access to finance was the chief factor affecting SMEs as credit had tightened for small enterprises in many of the countries under study. As a result, the SMEs had continued to perform poorly and many of them had failed. The study indicated that banks and non-bank financial institutions, which were going through financial crunches, were consolidating their own financial positions by ensuring adequate reserves as a precaution against delinquency and default. These prudential measures had reduced the flow of new lending and the extension of existing credit lines in many countries under study (Vandenberg, 2008). The implications of this study implied that SMEs access to credit was affected by the surrounding economic situation of the countries under study.

The researcher observes that though this study put into consideration some of the credit risks that SMEs face and their effect of their performance, it is evident that the survey was done to bring out the general situation of SMEs in the countries under study. This information, though important, does not answer the questions raised in the present study about the effect of financial risks in SME hotels. This study therefore intends to fill in this gap by carrying out a study focusing on SME hotels.

In Nigeria, in a study on the credit availability of small and medium enterprises through desk review, Ogujuiba, et al., (2004) reported that finance was usually a constraint to SMEs. Most SMEs were folding up or lacked competitiveness because they lacked the much required financial capacity to prosecute their operations. One of the reasons cited in this report was that of financial stringent attached to loan and credit which discouraged SMEs from accessing credit form the bank. Oguijuiba et al., (2004) observed that even with the establishment of the second tier security market of the Nigerian stock exchange as a palliative measures to solve the financial problem of SMEs, most SMEs shunned it because of the tight procedure and administrative bottleneck in the assessment of credit facilities.

The researcher observes that this study was carried out through desk review and there is a possibility that the data captured does not represent the actual situation on the ground. In addition, the study did not specify the type of SMEs that were involved in the study nor the scope of the study. This researcher seeks to fill in this gap by carrying out the present study through questionnaires in order to capture the situation on the ground. The study also intends to also focus on SMEs hotels in Nakuru, Kenya and thus having a practical scope. In Ghana, Aryeetey and Ahene (2007) carried out a study on changing regulatory environment for SMEs and their performance in Ghana, the study results indicated that access to credit had been on be of the main bottlenecks to SME development in the country. This was a result of fluctuating inflation rate in the country and the constant change in the rate of interest charged on loans by both banks and non-banks financial institutions. The study was carried out through a survey conducted in two metropolitan areas in Ghana, Acrra and Tema. The study involved 200 SMEs using a structured questionnaire to interview entrepreneurs/owners of these firms. The firms were drawn from various sectors including food processing, garments and textiles and the hotel industry.

The researcher observes that this study was carried out in the various sectors of the SMEs in Ghana and therefore the information cannot be generalized to represent the effects of financial risks in SME hotels as other sectors are involved. The study by Aryeetey and Ahene (2007) cannot therefore be relied upon to answer conclusively the questions raised in the present study. The researcher therefore intends to fill in this gap by carrying out a study focusing on the SME hotels only.

Letting and Muthoni (2010) in a study on innovation through business planning among SMEs in Kenya through desk review observed that some of the key constraints that were being faced by the Kenyan SMEs were accessing adequate and timely financing on competitive terms, particularly longer term loans, accessing credit on easy terms had become difficult in the backdrop of the prevailing global financial crisis and the resultant liquidation constraints in the Kenyan financial sector. In addition, financing constraints faced by Kenyan SMEs were attributed to a combination of factors that include policy, legal/regulatory framework, institutional weaknesses and lack of reliable credit information on SMEs.

Letting and Muthoni (2008) observed that it had become difficult from lenders to be able to assess risk premiums properly, creating differences in the perceived versus real risk profiles of SMEs. Other constraints include lack of access to skilled manpower, insufficient research and development facilities, availability of finance at cheaper rates, decision-making skills, good management and accounting practices, and access to modern technology. The researchers admitted that the study was not conclusive and recommended that more studies need to be done on SMEs to establish some of the issues ailing the performance of SMEs in Kenya. The present study intends to fill this gap by carrying out the present study.

3.Methodology

3.1.Research Design

The study adopted a survey design to collect data from small and medium hotel establishments within Nakuru Municipality. The design was chosen because it is an efficient method of collecting descriptive data regarding characteristic of a sample of a population, current practices, conditions or needs. The design was used because it allows the researcher to collect a large amount of data directly from the field in a highly economical way. In addition, it was a more appropriate way of obtaining primary data about individual's perceptions, attitudes, behaviour, or values.

3.2.Location Of The Study

The study was conducted within Nakuru Municipality. The Municipality is located within Nakuru district in the larger Nakuru County. The rationale for carrying out the study in Nakuru was informed by the fact that Nakuru is the fastest growing town in Africa (UNDP, 2009). In addition, Nakuru is also known for its magnificent sceneries including Lake Nakuru, Lake Elementaita, Hyrax hills and many other sceneries. For this reason, the town is a tourist attraction centre and therefore the hotel industry, which is within the tourism sector needs to tap in to this.

3.3.Target Population

The study involved a survey of 36 SME hotels within Nakuru Municipality, Nakuru County. These hotels have been categorized as Large-High standard hotels, Medium-High standard Hotels and Small-High standard Hotels (Municipal Council of Nakuru Register, 2012).

3.4.Sampling Procedure And Sample Size

The study employed a census of all the 36 SME hotels within Nakuru Municipality. The survey targeted accountants as respondents for data collection because they are typically the most knowledgeable and resourceful people regarding the organizations' (hotels') finances and overall hotel financial performance.

3.5.Data Collection Methods And Instruments

The main type of data used in the research was primary data which was collected by use of self administered structured questionnaires. The questionnaires targeted the hotel accountants. The questionnaire for the accountant was divided into six parts: part one which gathered general and demographic information, part two looked at the awareness of the financial risks affecting SMEs, part three, four and five addressed the credit, cash flow and profit risks that affect performance of SMEs while part six looked at the performance of the SMEs. Activities before the fieldwork process consisted of instrument design and development. Questionnaire administration involved pre-contact with the respondents and distribution of questionnaires. A letter of introduction was attached to the questionnaires explaining the purpose of the study. Questionnaires were collected after two weeks from the date of administration. Secondary data was obtained from records and documents such as purchase records, sales records, cash budgets and financial statements if available.

3.6.Data Analysis

Descriptive statistics (frequencies and percentages) was used to describe the findings as they are while inferential statistics (Correlation) was used to check the relation between financial risks and performance.

4.Findings And Discussions

Objective one of the study sought to establish the effects of cash flow risks on performance of hotels. Study findings on cash-flow risks reveal that the average revenues among the hotels increased steadily over the period 2009-2011 while the balances reduced over the same period.

4.1.Testing Hypothesis 1

This was tested by determining the person product moment correlation between cash flow risks and performance of small and medium hotels in Nakuru Municipality. The test was done at a significance level of 0.05.

		Level of sales performance	**Revenue from Food**	**Revenue from Accommodation**
Cash-flow Risks	Pearson Correlation	.043	-.940(**)	-.960(**)
	Sig. (2-tailed)	.821	.001	.002
	N	30	30	30

Table 1: Correlation Between Cash Flow Risks And Hotel Performance
*** Correlation Is Significant At The 0.01 Level (2-Tailed)*
** Correlation Is Significant At The 0.05 Level (2-Tailed)*

The test results indicated that cash-flow risks did not significantly influence sales growth (r = 0.043). However, cash-flow risks was found to negatively and significantly influence food revenue (r = -0.940**) as well as accommodation revenue (r = - 0.960**). The study therefore rejects the null hypothesis H_{01} and accepts the alternative H_{11}. Cash flow risks significantly affected revenue performance.

With regard to credit risks among businesses, study findings generally indicate that most hotels in the study area used credit facilities in the running of the business even though there were difficulties in to access credit by most businesses. Also, study findings generally show that the average percentage credit sales as well as percentage bad debts generally remained steady over the period 2009-2011. In addition, findings indicate that the general status of credit risks was generally moderate in the hotel industry. Finally, study findings reveal that credit risks affected performance of the hotel industry generally to a moderate extent.

4.2.Testing Hypothesis 2

To establish this person product moment correlation was calculated between credit risks and the performance of small and medium hotels in Nakuru Municipality.

		Level of sales performance	**Revenue from Food**	**Revenue from Accommodation**
Credit Risks	Pearson Correlation	-.090	-.990(**)	-.999(**)
	Sig. (2-tailed)	.637	.000	.000
	N	30	30	30

Table 2: Correlation Between Credit Risks And Performance Of Hotels
*** Correlation Is Significant At The 0.01 Level (2-Tailed)*
** Correlation Is Significant At The 0.05 Level (2-Tailed)*

Results of the correlation analysis indicates that credit risks significantly influenced sales growth (r = -0.090, p >0.05). However, credit risks was found to negatively and significantly influence food revenue (r = -0.990**, p <0.05) as well as accommodation revenue (r =- 0.990**, p < 0.05). This implies that credit risks significantly affect revenues of small and medium hotels in Nakuru. The study therefore rejects the null hypothesis H_{02} and accepts the alternative H_{12}. That credit risks significantly affect revenue performance of small and medium hotels in Nakuru Municipality.

On the basis of profit risks among businesses, the study found out that the percentage profits by hotels in the study area increased steadily over the period 2009-2011). In addition, study findings indicate that the overall effect of profit risks on performance of hotels in the study area was generally high.

Study findings on various aspects of business performance revealed that a significant number of the hotels retained their 60.97% of their employees. Furthermore, the business sales increased generally to a great extent while the mean hotel revenue generally increased steadily over the period 2009-2011. It was also evident that the mean capacity of hotels generally remained constant in all the categories over the period 2009-2011). Finally, study findings reveal that revenue from single rooms was fairly steady while the revenue generally decreased among the single rooms with suite, double rooms with suite and double rooms with deluxe over the period 2009-2011.

4.3.Testing Hypothesis 3

These were tested at a preset significance level of 0.05. In this regard, pearson correlation coefficient was determined between the level of profit risk exposure and the hotel performance in three dimensions sales performance, revenue from food and revenue from accommodation.

		Level of sales performance	**Revenue from Food**	**Revenue from Accommodation**
Profit Risk s	Pearson Correlation	.002	-.147	-.280
	Sig. (2-tailed)	.990	.728	.591
	N	30	30	30

Table 3: Correlation Between Profit Risks And Hotel Performance
*** Correlation Is Significant At The 0.01 Level (2-Tailed).*
** Correlation Is Significant At The 0.05 Level (2-Tailed).*

Results on Table 4.8.3 shows that profit risks did not significantly influenced sales growth ($r = -0.020$, $p > 0.05$), food revenue ($r = -0.147$ $p > 0.05$) and revenue from accommodation ($r = -0.280$ $p > 0.05$). The study therefore rejects alternative hypothesis H_{03} and accepts null hypothesis H_{03}. Profit risks do not affects performance of small and medium hotels in Nakuru Municipality.

5.Conclusion

On the basis of descriptive findings, it can be concluded that the financial risks are experienced among businesses, study findings indicate that profit and credit risks are the financial risks commonly experienced by hotels in the study area. Similarly, the findings generally suggest that profit and credit risks greatly affected the businesses in the study area. It is also evident from the findings that the average revenues among the hotels increased steadily over the period 2009-2011 while the balances reduced over the same period. This implies that the hospitality industry in the study area had witnessed favourable cash-flow environment, effective knowledge management strategies. This implies that most businesses in the hospitality industry have not been negatively affected by the cash-flow risks.

With regard to effect of credit risks in the hotel industry, the study conclude that most hotels in the study area used credit facilities in the running of the business even though there were difficulties in to access credit by most businesses. Also, study findings generally show that the average percentage credit sales as well as percentage bad debts generally remained steady over the period 2009-2011. In view of these findings, the study concluded that businesses in the hotel industry embraced increased credit sales and still experienced bad debts. On the basis of profit risks among businesses, the study concluded that the percentage profits by hotels in the study area increased steadily over the period 2009-2011 whereas the overall effect of profit risks on performance of hotels in the study area was generally high.

The study further concluded that most of the businesses were able to retain a significant number of their employees, witnessed steady increase in sales as well as increased hotel revenue during the period 2009-2011. Nevertheless, the mean capacity of hotels generally remained constant in all the categories whereas revenue generally decreased among the single rooms with suite, double rooms with suite and double rooms with deluxe over the period 2009-2011. It is therefore evident that the capacity of the existing hotels in the study area has not increased to meet the increasing demand for hospitality services. It is also worthy noting that revenue from accommodation has reduced during the period 2009-2011.

On the basis of correlation analysis results, the study concluded that that cash-flow risks and credit risks were found to be negatively related to revenue from food and accommodation. This implied that cash-flow risk and credit risks are responsible for the observed reduction in revenues from food and accommodation in the hotels. Nevertheless, regression analysis results confirm that the identified financial risks (cash-flow risks, credit risks and profit risks) did not significantly influence the performance of the businesses in the hotel industry but in most cases they negatively influenced performance especially the revenues from food and accommodation.

6.Recommendations

It is evident from the study findings that growth in capacity of the existing hotels in the study area has not increased to meet the increasing demand for hospitality services in the region. It is also worth noting that revenue from accommodation has reduced during the period 2009-2011. The study thus recommends that the businesses in hotel industry should come up with strategies for improving profitability in the hotel businesses in Nakuru Municipality so as to increase investment to match the increasing demand for accommodation services in the area. It is also noticeable that businesses in the hotel industry embraced increased credit sales but still experienced bad debts. Consequently, the businesses need to adopt effective measures for reducing the bad debts in order to attain increased revenues which could be highly attributed to the prevailing credit risks. Therefore small and medium hotels in Nakuru Municipality should highly emphasize on cash sales as a strategy for minimizing credit risks thus increasing revenue performance for both food and accommodation services. Furthermore, access to credit facilities by the businesses should be made easy to address the cash-flow problems whenever they arise.

In addition, it was evident from the study findings that the financial risks (cash-flow, and credit) negatively influenced performance especially the revenues from food and accommodation in hotel industry. This study recommends that the hotel advocacy bodies together with investors in hotel businesses in Nakuru municipality should device measures for risk analysis, measurement, prevention, minimization and mitigation to ensure that financial risks do not affect performance of hotels while addressing other factors that affect performance of the hotel businesses.

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