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Factors Leading to Poor Performance and Subsequent Closure of Small Businesses in Kenya: The Case of Thika Sub County

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Abstract:
A business is an organization or an entire market sector such as agriculture whose main purpose is profit generation. Small and Micro Enterprises (SMEs) that employs up to 50 staffs form the backbone of Kenya's economy, contributing a big percentage of the Gross Domestic Product. Despite their significance, small businesses have continued to face challenges such as inability to secure credit and meet clients' needs in terms of product quality and quantity among others. However, there is inadequate data on the factors leading to dismal performance and subsequent collapse of the small businesses as opposed to large scale enterprises hence the need for this study. The study was undertaken in Thika Sub-County of Kenya. It has assumed active participation of the sampled respondents as well as a favorable socioeconomic environment for its success. A descriptive research design has been used in the study where data from 42 sampled respondents was collected through questionnaires and analyzed using both qualitative and quantitative techniques. Data has been presented and analyzed using tables and findings discussed leading to the conclusion that lack of guarantors and difficult conditions by financial institutions as well as failure to utilize external advice are some of the key factors leading to poor performance of small businesses. The study has recommended adoption of computerized financial management systems by SMEs to improve on their profitability and sustainability.

Keywords: *Business, advise, auditing, capital, credit, accounting*

1. Introduction

1.1. Background to the Study
Small businesses have been defined in many ways, but the number of employees in a business is mostly relied upon to distinguish and classify businesses as small, micro or large. A Micro business or enterprise is defined as having less than 10 employees; a small enterprise with 11-50 employees and a medium/large enterprise with more than 50 employees. Small and Medium Enterprises are small in nature - either in terms of number of (a) employees (b) capital and assets - limited working capital and assets and (c) turnover - the overall turnover of the enterprise is small, compared to larger businesses (Nkonge 2013).
A business may refer to an organization or an entire market sector such as agricultures. Since there are different forms of businesses it is the sole discretion of the investor to decide on the type of business to start or invest in. Each of the business types has its own merits and demerits. However, a discussion on the merits and demerits of different business types is beyond the scope of this study. The forms of business available to investors are sole trader or proprietorship, partnership, trust or company. Apart from forms of business there are also different kinds of business that a trader may choose to start or run depending on their personal circumstances, interests, finances and business objectives. Some of the business kinds include; franchise, online business, family business, home based business, independent contractor, importer and exporter.
Business facing challenges have been found to exhibit unusual characteristics. Some of these characteristics are; inability to secure credit from credit providers such as banks, are unable to meet clients needs in terms of quality of products and quantity, are laying off staff or staff are resigning from the business and appear to be stagnant in areas it was doing well. Another characteristic especially for a franchise is closing down some of its branches and subsidiaries. On the contrary a business doing well exhibits characteristics opposite to these of a business facing challenges.
Business have an impact on the national economy and the economy can also determine the performance of the business. In a strong economy, nearly all businesses enjoy greater prosperity. Disposable income is high, unemployment is low and consumer confidence prompts people to pump their money back into the economy through the purchase of essential and nonessential goods and services (McQuerrey 2015). During economic slowdown all businesses suffer. Consumers become concerned about their job stability and, in

turn, are more likely to be cautious with expenditures, which leads to decreased revenue for small business owners. A slow profit stream can make it difficult for a small business to repay creditors, which can negatively impact its long-term viability. Some types of small businesses thrive in a slow economy. For example, companies that are involved in facilitating home foreclosures and vehicle and property repossessions find their businesses on an upswing during a slow economy. Additionally, small business owners with solid and substantial financial backing may see an increase in expansion opportunities by buying out their struggling competitors or absorbing the customer bases of out-of-business competitors (McQuerrey 2015). Business pay taxes to governments making them key to state operations. It therefore holds that when businesses perform well the government also benefits from increased revenue in form of taxes. Poor performance of businesses leads to poor economy and inability to service loans and finance/support social amenities.
According to Njeru, Namusonga and Kihoro (2012) in many developing countries, entrepreneurs have limited access to formal credit. In Sub-Saharan Africa, for example, the banking-sector penetration is roughly 10% of the population (Stein, 2001). In Kenya, there are about 2.2 million micro-, small- and medium-sized enterprises (Strategic Business Advisors Africa Ltd, 2007), of which 88% are non-registered. Of this non-registered group, only 23% have bank accounts, and only 10% have ever received credit from any formal source. Atieno (1998) observed in a survey done in Kenya that about 70% of the respondents got their initial capital from family, friends and relatives while 81% got their operating capital from the same financier.
Businesses require staff to perform different functions which makes them critical in local employment. In addition, business produces goods and services to supply the local and foreign markets. In terms of raw materials they utilize most of the locally available raw materials because they are more cost effective due to low transport costs. The spin effect caused by this is big leading to expansion of closely related business chains. Another advantage of local businesses is that more of the money spent at a local business stays in the local area. A study done in 2003 in Austin, Texas, by the American Independence Business Alliance showed that out of every $100 spent at a nationwide chain store, only about $13 stayed in the local economy. However, out of every $100 spent at a locally owned and operated business, about $45 stayed in the local economy. This provides a huge boost to other local businesses, workers and families in the local area (Alexis 2015). This finding makes businesses in any economy very important hence the need to understand all aspects pertaining to their success or failure.

1.2. Description of Study Area
This study was undertaken in Thika Sub County within Kiambu County, Kenya. Thika Sub County covers an area of 1,960.2 Km². It borders Nairobi City to the South, Kiambu Sub County to the west, Maragua Sub County to the north and Machakos Sub County to the east. The Sub County lies between latitudes 3°53′ and 1° 45′ south of Equator and longitudes 36° 35′ and 37° 25′ east. It is divided into 6 divisions namely Ruiru, Gatundu South, Thika Municipality, Kakuzi, Gatanga, and Kamwangi (Gatundu North), 20 locations and 89 sub-locations (GOK 2005).

1.3. Purpose of the Study
The purpose of this study is to establish the factors that lead to poor performance and subsequent closure of small businesses in Kenya

1.4. Assumptions of the Study
This study assumes that sampled respondents will freely provide information sought by the researchers. In addition it is assumed that there will be conducive environment (peace and political stability) for undertaking the research work in all areas that shall be sampled.

2. Research Methodology

2.1. Introduction
This section will detail design of the study, data collection, validity and data analysis.

2.2. Research Design
A qualitative research design which includes techniques and measures, which do not produce discrete numerical data (Mugenda and Mugenda 2003) was used in this study.

2.3. Data collection
Purposive sampling and stratified random sampling techniques were used to ensure representativeness of the population. The sub county has areas where small businesses are more concentrated compared to other areas. Small businesses managers and proprietors provided information through interviews and questionnaires. A composite questionnaire was utilized to collect required data.

2.4. Validity
According to Gatumu (2009) when a research has internal validity it means any relationship, may it be casual or oterwise, observed between two or more variables should be meaningful in its own right, rather than being as a result of a third variable (extraneous variable). External validity is the degree to which results of a research can be generalized to the entire population. To ensure internal validity, the research instruments will be shared with expert whose professional input ensured the instrument was well constructed to measure the required parameters.

2.5. Data Analysis

Two data analysis techniques namely qualitative and quantitative techniques were used. Data from questionnaires was reviewed in full. The data was thereafter coded so that responses were grouped and analyzed to yield results.

2.6. Operationalization of Variables

In this study, the independent variables have been identifies as access to capital, Management accounting practices and external advice. These variables will be manipulated to determine their effect on the dependent variable which is Business performance. However, there is extraneous variable which is government regulations that the researcher will remain aware of since it can have effect of the dependent variable.

3. Results and Findings

3.1. Questionnaire Return Rate

A total of 42 questionnaires were sent out to sampled respondents and 36 were filled in and returned. This presents a return rate of 85.7%. The questionnaires not returned were 6 representing 14.3%. This indicates willingness of target respondents to participate in the study. This data is shown in Table 1.

Category	Number of respondents	Percentage (%)
Questionnaires returned	36	85.7
Questionnaires not returned	6	14.3
Total	42	100

Table 1: Questionnaire return rate

High rate of questionnaire return rate indicates willingness of respondents to participate in the study

3.2. Access to External Financing

The study sought to establish the percentage of sampled SMEs who had at any one time accessed external financing for their business and the results were as follows; 32 out of 36 (89.8%) respondents had accessed external financing will 4 out of 36 (11.1%) had never accessed external financing. The data is presented in Table 2

Category	Number of respondents	Percentage (%)
Accessed external financing	32	88.9
Never accessed external financing	4	11.1
Total	36	100

Table 2: Percentage of SMEs that accessed external financing

From this data it shows that SMEs do access external financing for their business ventures.

3.3. Challenges Encountered in Accessing External Financing

The study sought to find out the kind of challenges that SMEs encountered while seeking external financing for their businesses. This question was directed to the 32 SMEs who had accessed some form of external financing for their businesses. 7 out of 32 (21.9%) respondents cited lack of loan guarantors as main challenge while 5 out of 32 (15.6%) respondents said length of loan processing time was their challenge. However, 11 out of 32 (34.4%) respondents cited difficult conditions such as having bank accounts with specified average minimum amounts and having detailed business plans as some of the conditions to be fulfilled prior to accessing loans as the main challenge. The issue of high interest rates was cited by 3 out of 32 (9.4%) respondents as being a barrier to accessing external financing. A total of 6 out of 32 (18.8%) respondents reported inadequate collateral as the barrier to accessing external financing especially from banks. The data obtained from the field is summarized in Table 3.

Type of challenge	Number of respondents	Percentages (%)
Lack of guarantors	7	21.9
Long processing time	5	15.6
Difficult conditions by lenders	11	34.4
High interest rates	3	9.3
Difficult getting Collaterals	6	18.8
Total	32	100

Table 3: Challenges experienced in accessing external financing

From this data it shows that SMEs face many challenges while attempting to access external financing for their businesses.

3.4. Management Accounting Practices Used by Small Businesses

The study sought to understand the management accounting practices undertaken by small business. In this endevour, the study asked respondents several questions as indicated in the succeeding section.

3.4.1. Methods Used in Keeping Financial Records

The study asked respondents whether they keep their financial records manually or using computerized systems and the following reactions were received. 22 out of 36 (61.1%) respondents use manual system of record keeping. 14 out of 36 (38.8%) respondents use computerized system in record keeping. The data is tabulated in Table 4

Category	Number of respondents	Percentage (%)
Manual system	22	61.1
Computerized system	14	38.9
Total	36	100

Table 4: System used to maintain financial records

This data indicates that most small business utilize manual systems which are not as efficient as computerized systems. This makes the businesses prone to suffer due to wrong decisions resulting from incorrect financial information.

3.4.2. Challenges Faced in Relation to Tax and Statutory Requirements

From the study, 14 out of 36 (38.9%) respondents experienced challenges with tax and other statutory obligations while 22 out of 36 (61.1%) had never had such challenges. This data is presented in the Table 5

Category	Number of respondents	Percentages
Faced challenges with tax and statutory requirements	14	38.9
Never faced tax and statutory challenges	22	61.1
Total	36	100

Table 5: Challenges with tax and other statutory obligations

From this data only a small percentage (38.9%) have faced some challenges related to taxation and regulatory obligations.

3.4.3. Use of Financial Accounting Practices in the Business

Respondents were requested to provide any two accounting practices they have used in the management of their businesses and the following information was provided. 6 out of 36 (16.7%) respondents have used some conventional accounting practices. A total of 30 out of 36 (83.3%) of sampled respondents had never used any known accounting practices to run their business. This information is provided in the Table 6

Category	Number of respondents	Percentage (%)
Used financial accounting practices	6	16.7
Never used financial accounting practices	30	83.3
Total	36	100

Table 6: Financial accounting practices used by sampled SMEs

This data indicates that SMEs without use of financial accounting systems thus exposing them to decisions not embedded on any proven strategies

3.5. Use of External Expertise and Guidance

The study sought to understand the extent to which SMEs employ external auditing and guidance for the management of their businesses. Towards this end, the study posed a number of questions to sampled respondents that yielded different results.

3.5.1. External Financial Auditing

The researcher posed the question on external auditing to understand whether the SMEs do auditing for the business and take advantage of the external expertise in managing their businesses. The data collected indicated only 22 out of 36 (61.1%) sampled respondents employ external auditing while 14 out of 36 (38.9%) respondents do not. This data is shown in Table 7.

Category	Number of respondents	Percentage (%)
Undertake external financial auditing	22	61.1
Do not undertake external financial auditing	14	38.9
Total	36	100

Table 7: External financial auditing

This data indicates that the businesses do understand the benefit of external guidance in the general management of their businesses.

3.5.2. Use of External Advise in Management of the Businesses Entities

The study asked 22 sampled respondents who indicated they undertake external financial auditing to explain how they have benefitted from external advise in the management of their business enterprises and the following data was collected. Sealing of accounting loopholes, planning, reporting, determination of profit and losses and accessing external finances were some of the uses provided by respondents. This data is presented in Table 8

Category	**Number of respondents**	**Percentage (%)**
Seal accounting loop holes	6	27.2
Planning	8	36.4
Reporting	2	9.1
Accessing loans	2	9.1
Determining profit and loss	4	18.2
Total	22	100

Table 8: Use of external audit results in business management

The data above indicates that SMEs do know the benefits of external advise including external auditing as indicated by various uses to which the results have been used.

3.5.3. Reasons for Some Businesses Not Undertaking External Auditing

The 14 SMEs that indicated they do not undertake external auditing were required to give explanation why they do not deem it necessary and the following results were received. Some indicated that they want to reduce costs while others considered their businesses too small to warrant external financial auditing. This data is presented in Table 9

Category	**Number of respondents**	**Percentage**
Manage business costs (Overheads)	6	42.9
Too small entities	8	57.1
Total	14	100

Table 9: Reasons for not undertaking external financial auditing

This information indicates that business overheads and the small size of business entities determine the decision made by business owners in terms of engaging in external auditing.

3.6. Strategies for Accessing Additional Financing

The study sought to get suggestions from sampled respondents in terms of helping small scale business access additional financing and received the following key suggestions

i) Lobby government to create a better policy framework to influence commercial financing institutions to lower credit terms
ii) Creation of linkages and partnerships with like-minded business entities to enjoy economies of scale
iii) Influence banks and other financial institutions to reduce conditions for accessing credit to small scale businesses
iv) Help small businesses keep accurate books of accounts to inform decision making

3.7. Summary of the Study

A synopsis of the findings is presented in the Table 10

Objective	Findings
To examine the challenges experienced by small businesses in accessing capital in Thika sub county	• The study established that SMEs were interested in accessing external funding as evidenced by 88.9% of respondents who had accessed some form of external financing. • The challenges encountered by SMEs were 5 as identified by respondents. These are; lack of guarantor for loans (22%of respondents), long processing periods (15.6% of respondents), difficult conditions demanded by lenders (35% of respondents), high interest rates (9.3% of respondents) and lack of collaterals (19% of respondents).
To examine the management accounting practices of small businesses in Thika Sub County	• The study established that manual accounting system is mostly used by SMEs at 61.1% of sampled respondents compared to 39% of respondents who used computerized systems. • Many SMEs have never experienced tax or statutory challenges as shown by 61% of respondents compared to 39% who had experienced some problems. • Many SMEs do not use standard accounting practices for management of their operations. At least 83.3% of respondents reported having never used such systems.
To establish the benefits of external financial audits commissioned and undertaken by small businesses	• A big percentage of SMEs do not undertake external auditing as evidenced by 61.1% of sampled respondents who never used the external audits citing prohibitive costs. However, 39% of sampled respondents undertook external financial auditing on their businesses. • Benefits of seeking external financial advice such as external auditing are relatively understood at varying levels by SMEs as shown by the study where sampled respondents provided the following information on how they make use of the advice. i) Seal accounting loopholes (27% of respondents) ii) Planning purposes (36% of respondents) iii) Reporting purposes (9% of respondents) iv) Accessing loans (9% of respondents) v) Establish profit and loss status (18% of respondents)

Table 10: Summary of findings

4. Conclusions

Based on its findings, this study has concluded the following;

1. SMEs are interested in accessing external financing for their businesses but are hampered by challenges such as lack of guarantor for loans, long processing periods for loans, difficult conditions demanded by lenders, high interest rates and lack of collateral
2. Failure to adopt computerized accounting as well as standard accounting systems are among the key factors hampering success of small and micro enterprises
3. Benefits of external financial advice have not been fully utilized by SMEs to spur growth in their respective areas. External advice such as financial auditing can help SMEs in sealing accounting loopholes, business planning, adequate reporting, accessing external loans from financial institutions and establishing profits and losses incurred by the business within a given period of time.

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