



**FACTORS INFLUENCING THE FINANCIAL PERFORMANCE OF SMALL
MANUFACTURING FIRMS IN KISII COUNTY, KENYA**

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Abstract

Small manufacturing firms face a lot of challenges in their operation. These challenges range from financial constraints, innovation constraints and management constraints. These challenges have a lot of impact on growth, profitability and financial innovation. The study sought to establish the extent to which financial constraints, innovation constraints and management constraints influence the financial performance of small manufacturing firms in Kisii County. The study findings showed significant relationship exist between financial constraints, innovation constraints and management constraints on performance of small manufacturing firms. Financial factor was statistically significant in influencing performance of SMFs (Beta=0.093, P<0.05), Innovation factor influenced performance of SMFs (Beta=0.232, P<0.05), Management factor influenced performance of SMFs (Beta=0.03, P<0.05). There is need for the government to foster innovation amongst SMFs through creation of a business environment conducive for entrepreneurship. SMFs need to focus on improving their core competences, to pursue market innovation strategies that focus on product customization and customer intimacy in delivering their products and services.

Keywords: Financial Factor, Financial Performance, Management Factor, Small Manufacturing Firms

1. INTRODUCTION

Small manufacturing firms have been known to contribute greatly in economic growth of both developed and developing countries. According to Wanjohi (2010), SMFs in employment tend to be higher in developing countries. The share of SMFs in employment tends to be higher in developing countries, which are typically more focused on small scale production. As such he noted that policy provision remains fundamental in propelling these firms towards self sustenance and realization of their full potentials in contributing towards economic growth (Wanjohi, 2010). Larsen and Lewis (2008) noted that SMFs faces different barriers to survival, growth and innovation. They observed that majority of failures in SMFs performance were due to multiple factors such as undercapitalization, insufficient working capital, short term liquidity problems, insufficient startup capital, innovation constraints and poor management. In Kenya for instance, SMFs operation cut across all sectors of the economy and sustain majority of households. The sector ranges from Agriculture, Manufacturing and financial sector just to mention but a few. These SMFs activities provide a breeding ground for business and employee and provide one

of the most prolific sources of employment and economic growth in Kenya.

Kisii County is one of the fastest growing counties in western Kenya with its headquarters being Kisii Town. The population of Kisii Town is estimated to be about eight hundred thousand with a majority of employable work force engaged in small and medium enterprises programme. In Kisii town, SMFs conduct their economic activity virtually in all sectors of the economy. These include agriculture, transport, finance, small scale artisan and manufacturing and construction.

2. Statement of the Problem

Various studies has been done on SMFs to identify how best to manage their activities in order to contribute to the economic development of the nation, but not much has been researched on the effects of financial, innovation and management constraints on the financial performance of small manufacturing firms in Kenya especially in Kisii County. Unlike other previous studies this study used too both financial and non-financial metrics to measure financial performance to give a broader view on the effects of financial, innovation and management constraints on the financial performance of small manufacturing firms

in Kenya especially in Kisii County. This informed this study to fill the gap on why most small manufacturing firms perform dismally and end up closing down after a few months or years of operation in Kisii County.

3. Objectives of the Study

The objectives of this study were to:

- i. Establish the extent to which financial factor influence the financial performance of small manufacturing firms.
- ii. Establish the influence of innovation as a factor on the financial performance of small manufacturing firms.
- iii. Find out the influence of management factor as a factor on the financial performance of small manufacturing firms.

4. Research Questions

The study was guided by the following research questions:

- i. To what extent do financial constraints influence the financial performance of small manufacturing firms in Kisii County?
- ii. To what extent do innovation constraints influence the financial

performance of small manufacturing firms in Kisii County?

- iii. To what extent do management constraints influence the financial performance of small manufacturing firms in Kisii County?

5. Research Methodology

The study used the descriptive cross-sectional research design. The study population was the 200 small manufacturing firms operating in Kisii County. The researcher used stratified random sampling, to obtain a sample size of 60 registered manufacturing small and medium enterprises within Kisii County. Questionnaires were used for collecting data which were analyzed using descriptive and inferential statistical tools and presented using tables

RESULTS AND DISCUSSION OF FINDINGS

6. Factors Influencing the Financial Performance of Small Manufacturing Firms

The study sought to establish the effects of financial factors on the financial performance of small manufacturing firms. Table 1 presents the results obtained.

Table 1: Financial Factors and Performance of Small Manufacturing Firms

Financial Factors	N	Min	Max	Mean	Std. Dev
Access to financial resources has enhanced the expansion of my firm thus improving financial performance.	55	3.00	4.00	3.9583	.20123
Financial accessisbilty has enhanced investment in modern innovations by my firm thus improving financial performance.	55	3.00	5.00	4.5694	.74732
Financial accessisbilty has enhanced the acquisition of more resources including capital assets thus improving financial performance.	55	3.00	5.00	3.9444	.37110
Financial accessisbilty has enhanced investment thus improving productivity.	55	3.00	4.00	3.9861	.11785
Financial accessibility has enhanced mitigating business risk.	55	3.00	5.00	4.0278	.53001

From the results obtained, it was established that most of the respondents agreed that access to financial resources had enhanced investment in modern innovations by their first thus improving financial performance as shown by the mean of 4.5694. The respondents also agreed that access to financial resources had enhanced the countering of business risks by their firms as shown by the mean of 4.0278; access to financial resources by their firms had enhanced the investment in personnel development thus improving productivity and consequently financial performance as shown by the mean of 3.9861; access to financial resources had enhanced the expansion of their firms thus improving financial performance as shown by the mean of 3.9583 and that access to financial

resources by their firms had enhanced the acquisition of more resources including capital assets thus improving financial performance as shown by the mean of 3.9444. Thus it can be deduced from the study findings that financial factors have a significant effect on the financial performance of small manufacturing firms.

This study results agrees with Cook and Nixson (2000) who explain that the role of finance is viewed as a critical element for the development of SMEs. Schmidt and Kropp (1987) posit that 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.

performance of small manufacturing firms. Table 2 presents the results obtained.

7. Innovation Factors and Financial Performance of Small Manufacturing Firms

The study sought to establish the effects of innovation factors on the financial

Table 2: Innovation Factors and Financial Performance of Small Manufacturing Firms

Innovation Factors	N	Min	Max	Mean	Std. Dev
My firm has adopted process innovations that have led to increased output quality in manufacturing processes, techniques, machinery and software.	55	3.00	5.00	3.9444	.37110
My firm has adopted product innovations leading to developing of new products thus improved ease of use for customers and to improved customer satisfaction.	55	1.00	5.00	3.8611	.99726
Marketing innovations adopted by my firm have led to renewing of our product pricing techniques, product promotion, increased sales and expanded our markets.	55	3.00	4.00	3.6111	.49092
Technological innovations adopted by my firm facilitate renewing of the routines, procedures and processes employed in coordination between different functions thus better firm performance.	55	2.00	4.00	3.6250	.72067
Innovations are expensive and can eat into the business profits.	55	3.00	4.00	3.4722	.50273
My firm's profitability, return on sales and return of assets have increased and/or reduced as a result of implementation/lack of implementation of process, product, marketing and technological innovations.	55	3.00	5.00	3.9861	.20508

From the results obtained, it was established that most of the respondents agreed that their firm's general profitability, return on

sales and return of assets have increased and/or reduced as a result of implementation/lack of implementation of process, product, marketing and

technological innovations as shown by the mean of 3.9861. The respondents' also agreed that their firms had adopted process innovations that have led to increased output quality in manufacturing processes, techniques, machinery and software. They have also led to determining and eliminating non value adding activities in delivery related processes and enhanced accountability and transparency as shown by the mean of 3.9444; their firms had adopted product innovations that have led to developing new products with technical specifications and functionalities totally differing from the current ones leading to improved ease of use for customers and to improved customer satisfaction as shown by the mean of 3.8611; technological innovations adopted by their firms facilitated renewing of the routines, procedures and processes employed to execute firm activities and coordination between different functions thus better firm performance as shown by the mean of 3.6250; marketing innovations adopted by their firms have led to renewing of product pricing techniques, product promotion techniques that favor their products/services, have reduced product promotion costs and increased sales and expanded their markets as shown by the mean of 3.611 and that innovations are expensive and can eat into the business profits as shown by the mean of 3.4722. It can be deduced from the study findings that

innovation factors had a significant influence on the financial performance of small manufacturing firms.

These findings concur to those of Ogubenga and Ekiti (2012), when they conducted a study on the investigation on the impact of technological, infrastructure and financial supports on the performance of SMFs in Nigeria. They found out that modern technology adoption eased business running and coordination in the SMFs. The result further coincide with those of Wu, Chang and Chen (2008) who found that mediating effects of product innovation on financial performance of SMFs, existing at significant levels. Inferences can therefore be drawn to imply that tendency of a firm to engage in and support new ideas, uniqueness, experimentation and creative processes results in new products and processes. Any innovation requires the firm to have competences relating to technology and relating to customers. Ngugi (2010) concluded that the tendency of manager to engage in and support new ideas, novelty, experimentation and creative processes results in new products and services which has great influence on the performance of business organisation. Therefore process innovativeness directly influences the growth of small manufacturing firms in Kenya

8. Management Factors and Financial Performance of Small Manufacturing Firms

The study sought to establish the effects of management factors on the financial performance of small manufacturing firms. Table 3 presents the results obtained.

Table 3: Management Factors and Financial Performance of Small Manufacturing Firms

Management Factors	N	Min	Max	Mean	Std. Dev
Management level of education has enhanced accountability and transparency in my firm.	55	2.00	5.00	4.1250	.80382
Management level of education has enhanced the generation of business capital and finances in my firm.	55	2.00	4.00	3.6250	.72067
Management level of education has enhanced adoption to new changes and innovations in my firm which have increased its financial performance.	55	3.00	5.00	3.7778	.45105
Management level of education has enhanced making of viable business plans in my firm.	55	3.00	5.00	4.1250	.78610
The management's level of experience in my firm has enhanced mitigation of risks and how to cop with them thus increasing the financial performance.	55	2.00	5.00	4.4306	.05918
The management's level of experience in my firm has enhanced skills of adopting to new business conditions and competition thus increasing the financial performance.	55	1.00	5.00	3.8056	.81602

From the results obtained, it was established that most of the respondents agreed that the management's level of experience in their firms had enhanced skills of prediction of risks and how to deal with them thus increasing the financial performance as shown by the mean of 4.4306. The respondents also agreed that management level of education and training enhances proper book keeping, accountability and

transparency in their firms and management level of education and training has enhanced making of viable business plans and their execution in their firms as shown by the mean of 4.1250; the management's level of experience in their firms had enhanced skills of adopting to new business conditions and competition thus increasing the financial performance as shown by the mean of 3.8056; management level of education and training had enhanced adoption to new

changes and innovations in their firms which have increased the financial performance as shown by the mean of 3.7778 and that management level of education and training had enhanced the generation of business capital and finances in their firms as shown by the mean of 3.6250. It can be concluded from the results that management factors had a significant influence on the financial performance of small manufacturing firms. These findings are in agreement with King and McGrath (2002) who observe that those with more education and training are more likely to be successful in the SME sector because they are better placed to adapt their enterprises to constantly changing business.

Balfanz and Koelmel, (2009) note that management training is a prerequisite for SMEs good performance. King and McGrath (2002) further 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.

9. Regression Analysis

This section illustrates the regression model derived, the model summary and the analysis of variance. Table 4 gives the coefficients which help in establishing the regression line.

Table 4: Table of Coefficients

Model	Un-standardized Coefficients		Standardized Coefficients	T	Sig
	B	Std. Error	Beta		
(Constant)	1.161	0.129		9	0
Financial Factors	0.482	0.064	0.093	7.53	0.03
Innovation Factors	0.342	0.05	0.232	6.84	0.01
Management Factors	0.218	0.04	0.03	5.45	0.04

The established regression equation was as follows;

$$Y=1.161+0.482 X_1+0.342 X_2+0.218 X_3$$

From the above regression model, holding financial factors, innovation factors and management factors to a constant zero, financial performance of small manufacturing firms would be 1.161. It was established that a unit increase in financial

factors would cause an increase in financial performance of small manufacturing firms by a factor of 0.482, a unit increase in innovation factors would cause an increase in financial performance of small manufacturing firms by a factor of 0.342. Also a unit increase in management factors

would cause an increase financial performance of small manufacturing firms by a factor of 0.218.

This clearly shows that there is a positive relationship between financial performance of small manufacturing firms and financial factors, innovation factors and management

factors. The study further revealed that the *P*-value were less than 5% in all the variables, which shows that all the independent variables were statistically significant and thus in position to make conclusion for the study.

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.901 ^a	.811	.778	.88195

Adjusted R squared is a coefficient of determination that shows the variation in the dependent variable due to changes in the independent variables. From the findings in the above table 4.13, the value of adjusted R squared was 0.778, an indication that there was variation of 77.8% on financial performance of small manufacturing firms due to changes in financial factors, innovation factors and management factors at 95% confidence level. R is the correlation coefficient which shows the relationship between the study variables and from the findings shown in the table above there was a strong positive relationship between the study variables as shown by 0.901.

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

10. Summary of findings

The study targeted a sample of 60 small manufacturing firms in Kisii County; they were issued with questionnaires only 55 responded. This represented a response rate of 91.7% which is higher and can be used to represent the general population in Kisii County. The study focused on the effects of financial constraints, innovation constraints and management constraints on the financial performance of small manufacturing firms indicated by their return of assets.

10.1 Financial factors and Performance of Small Manufacturing Firms in Kisii County

The study established that the results of the study indicated that there was a significant relationship between financial constraints

and financial performance of small manufacturing firms in Kisii County as reflected by probability values of (0.038) for lack of adequate finance capital, (0.023) and limited access to credit (0.033). Majority (Mean = 4.55 and S.D = .158) of the respondents agreed that lack of adequate finance/capital was the major financial constraint influencing the financial performance of their firms, while the least (Mean = 3.88 and S.D. = .143) number of respondents agreed that new laws and regulations was the major financial constraint influencing the financial performance of their firms. The regression analysis results reveals that financial factors have statistically significant influence on the performance of small manufacturing firms (B=0.093, P<0.05).

10.2 Innovation factor and Performance of Small Manufacturing Firms in Kisii County

The study established that there is a significant relationship between product innovation constraints and financial performance of small manufacturing firms as reflected by the probability value of = (0.024). Majority (Mean = 2.55 and S.D = .158) of the respondents disagreed that in comparison with competitors, their firm had introduced more innovative products during

the past 3 years, while the least (Mean = 2.07 and S.D. = .065) number of respondents disagreed that their new products are often perceived the best by customers. The study findings also show that there is a significant relationship between process innovation constraints and financial performance of small manufacturing firms as evidenced by the probability value of (0.001). Most of the respondents disagreed (Mean = 2.44; S.D =1.167) that new business methods and services are always worth if they improve productions and delivery, while the lowest (Mean =2.22 and S.D. = .181) number of respondents disagreed that the firm rewards employees in terms of their productivity. The results show that there is a significant relationship between market innovation constraints and financial performance of small manufacturing firms in Kisii County as evidenced by the probability value of (.003). Most (mean = 2.40 and S.D = .283) of the respondents disagreed that their firms manage to deliver special products flexibly according to customers' orders, while the least (mean =2.16 and S.D. = .129) number of respondents disagreed that their firms introduce new marketing approaches (online marketing-business).

The regression analysis results reveals that Innovation factors have statistically significant influence on the performance of small manufacturing firms (B=0.23, P<0.05).

10.3 Management factor and Financial Performance of Small Manufacturing Firms in Kisii County

The results of the study indicated that there was a significant relationship between management constraints and financial performance of small manufacturing firms in Kisii County as reflected by probability values of (.000) for management ability to deploy resources efficiently, (0.014) for management ability to reduce operating costs and (.026) for management ability to maximize income. Majority (Mean = 2.48 and S.D = .196) of the respondents disagreed that their firm management had ability to deploy the limited resources efficiently, while the least (Mean = 2.28 and S.D. = .065) number of respondents disagreed that their firm's management had ability to maximize income.

The regression analysis results reveals that Management factors have statistically significant influence on the performance of small manufacturing firms (B=0.03, P<0.05).

11. Conclusions

Financial factors have a significant influence on the financial performance of manufacturing firms in Kisii County. Majority of these firms lacked adequate finance/capital and could not access credit thus impacting on their financial performance.

Innovation constraints have a significant influence on the financial performance of manufacturing firms in Kisii County. In comparison with competitors, most firms had not introduced more innovative products during the past 3 years. Most of the firms had also not introduced new business methods and services to improve productions and delivery. Similarly most firms had not introduced new marketing approaches (online marketing, e-business). Management constraints have a significant influence on the financial performance of manufacturing firms in Kisii County. Most of the management in these firms could not deploy limited resources efficiently and could also not maximize income as they reduce operating expenses.

12. Recommendations

Since lack of adequate finance and limited access to credit, high interest rates and new laws and regulations are the major financial challenges that have implication on growth,

profitability and financial innovation, the National and County Government should develop a clear policy framework to address these challenges to mitigate severity in terms of growth, profitability and financial innovation. The policy infrastructure should address increase accessibility of fund by SMFs, provision of interest rates caps specifically for SMFs and formulation of favorable policies that may allow SMFs to securitize their shares in security exchanges. In order for the SMFs to successfully achieve high product and service innovation both the government and enterprise management need to create a business environment conducive for entrepreneurship and enterprise creation in which innovative firms have scope to expand their product innovation. SMFs need to pursue market innovation strategies that focus on product customization and customer intimacy in delivering their products and services while at the same time cultivating relationships with a small number of captive customers. This market intimacy will help SMFs make up for lack of resources for market intelligence as the customers will be able to offer them information on their current need, any changes in market competition.

The government and other stakeholders need to promote these SMFs through training and skill acquisition that will enable them

manage their debts effectively, utilize their loans efficiently thereby reducing the probability of their being credit rationed and thus improving their performance.

13. Suggestions for Further Research

The present study relied largely on primary data and is therefore not enriched by the secondary data which would have enabled the study to provide a more in depth view of the subject matter. Therefore, secondary data need to be also included in future to complement primary data and to provide wider perspective to the present study.

Future research should look into area of lease financing and SMFs. This area may provide a fertile ground to understand the implication of lease financing on SMFs performance.

Future research in this area need to incorporate establishment of national and county government policies that promote innovation among the SMFs, besides widening the scope and sample size of the study and other aspects relating to product, process, marketing and even development innovations and their effects on the financial performance of SMFs.

It is also important that studies are conducted to determine if the effort by government both in the national and county level to address these constraints through various agencies is yielding any fruits.

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