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INFLUENCE OF ACCOUNTING PRACTICES ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISESIN KENYA: A SURVEY OF SMES IN NYAMIRA TOWN

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Abstract

Small businesses contribute towards an economy through creation of employment, hence resulting into innovation hence improves the economy of a country.However, there is limited information on SMEs that address the link between accounting practices and financial performance in Kenya. Thus, the study hoped to establish the influence of accounting practices on the financial performance of SMEs in Nyamira Town, Nyamira County, Kenya. Specifically, it sought to establish the influence of financial data collection, financial data recording and financial data analysis on the financial performance of SMEs in Nyamira Town, Nyamira County, Kenya. The Theory of the Firm, The Theory of Entrepreneurship and Financial Sustainability Theory anchored the study. Descriptive survey research was used for the above study. The study targeted the five hundred and fifty registered SMEs owners in Nyamira County. To select the sample from the population a random sample of 55 SME owners was used. The study used Cronbach's coefficient alpha model to test the reliability of research instruments while validity was tested using expert opinion.Descriptive statistics of the mean and standard deviation were used to analyse the data while to test for direction and strength the relationships, Pearson correlation and regression analysis were used. The results showed that: financial data collection, financial data recording and financial data analysis had a positive significant influence on the financial performance of SMEs in Nyamira town, Nyamira County, Kenya. The study thus recommended that: The SMEs owners and managers should engage in some elementary accounting training to enable them engage in proper recording of transactions to help them improve their financial performance. The SMEs owners and managers should invest in accounting information systems to ease and make it possible for effective and full accounting to help improve their financial performance. They should improve on their supplier payments of invoice to avoid unscrupulous dealings and allow for effective accounting practices to help improve their financial performance. The government should initiate policies that would make it mandatory for SMEs to have an accounting policy to help build the process and curb corruption in the process.

Keywords: Accounting, data collection, data recording, financial data analysis

I. INTRODUCTION

1.1 Background of the Study

Small businesses contribute towards an economy through creation of employment, hence resulting into innovation that will result into increase of Gross Domestic Production (GDP) in a particular country and boost of other economic activities (Gamage,2010) The growth of SMEs should speed up in developing countries so that to achieve sustainable development. In Kenya the number of SMEs continues to increase rapidly. Accounting information is very important to firms by helping it to succeed the problems it faces such as disbursement and cash flow of the company, which is able to provide information that supports evaluation process. (Mitchell *et al*., 2010).

Therefore, it is important for SMEs to ensure that accounting systems are used effectively and efficiently depending on the economic resources so that to pursuit the goals of the firms. It is also important that SMEs grow the skills of financial analysis that assist in reading and understanding financial statements by confirming if they contain forecasting and historical information (McMahon, 2015). Hence,this research attempted to ascertain inclusiveness of accounting and analysis practices that are adopted by SMEs in Kenya and gauge if accounting and analysis have an effect on the financial performance of the firms.

Firer *et al*. (2004)observes that firm owners want to use financial management so that to take advantage of maximizing wealth while on the other side the main aim of organization is to maximizethe value of shareholders. The firmsprice can be presented by using the price in the market of the organization common stock, that can be a reflection of the company's investment dividend decisions and financing.

Kuratko*et al*. (2015), Woodlift et al. (2010) and Newby et al. (2013) observe that the aims of SMEs can be evaluated in terms of qualitative (non-financial) and quantitative (financial). Financial returns are profit that a firm earns therefore it is important to have so much nonrefundable income so that to achieve monetary security and be able to form wealth for the family, for the coming generation. It is important for SMEs to have financial management strategy for the growth of the business. There is enough literature that explains financial management for SMEs that categorizes the mechanisms of accounting practices that are important to the performance of small businesses such as financial control and planning, accounting information, financial analysis and management accounting (Osman 2007; Azhar*et al.,*2010).

Accounting systems gives information to managers and owners of the SMEs that operate in any particular industry that can be used to measure the financial performance (Maseko

&Mayans2011). It is important for small businesses have accounting practices such as financial data collection, recording and analysis that is able to give complete and relevant financial information that will be able improve decisions made by entrepreneurs on economic. According to Ismail and Zin (2009) argue that business plan is an important component that assist small firms to grow. Padachi (2010) note that the key reasons contributing to the accomplishment or failure of SMEs can be grouped depending on both external and internal factors.

Son et al. (2006) argue that accounting information is important for organizations that operate in a competitive and dynamic environment so that to assist in integrating the operational initiatives for a long term plans. Sarapaivanich (2013) established that small business does not have access to capital hence resulting into inadequate accounting records and ineffective use of information for accounting. When SMEs do not know how to do proper record keeping of accounting information, it becomes difficult for financial organizations to gauge the likely of risks and returns hence it is difficult to lend to the small business.

It very difficult to categories medium enterprises to establish vis-à-vis the "small" and "big" business groups. In Kenya SMEs industry is characterized by employees between 5 to 20 and the capital assets is two million shillings (excluding property). There is no standard definition for SMEs in Kenya and it also vary with lenders, although it is defined as a firm with employees between 6 to 50 and have annual profit less than50 million Kenya shillings, irrespective of quantitative definition. Stakeholders in the market agree that SMEs in Kenya are the "missing middle". Statistics indicate that SMEs in Nyamira County are not doing so well in terms of financial performance. For example, Nyambura (2014) reported that in most rural-based urban centres, up to 60% of SMEs die within the first year of operation. These areas include Nyamira County. Several studies have investigated the influence of accounting practices on financial performance of SMEs in other areas but studies investigating the influence of financial accounting practices on financial performance of SMEs in Nyamira Town are missing.

1.2 Statement of the Problem

Small firms have a role towards economic growth by job creation among the youths hence eradicate poverty. The industry faces a number of problems such as markets, training, accessing finance and technology. SMEs face both opportunities and problems that affect their financial performance. To solve problems that face SMEs it is important to use accounting practices such as having appropriate recording of transactions, use of suitable accounting information systems, effective billing systems and supplier invoice payments. Previous research done on small –scale enterprises indicate that performance is less than the satisfactory. According to Nyambura (2014) established that manpower, marketing and finance are some of the major problems that small enterprises in the manufacturing. Mbuvi (2015) conducted a study in Machakos where it was established that family size which is an element of culture affects the performance of the business. Large families were found to withdraw large sums of money from the business to support their families with food, clothing, education and other needs leaving little to finance business operations.

Lastly, Mulinge (2009) examined how SMEs adopt marketing practices in Makueni District. From previous studies there is inadequate information available on the relationship between accounting practices and financial performance of small and medium enterprise in Kenya. Therefore, this study seeks to address the research gap by seeking to establish the influence of accounting practices on financial performance of small and medium enterprise in Nyamira Town.

1.3 Research Objectives

1.3.1 Main Objective

To establish the influence of accounting practices on the financial performance of SMEs in Nyamira town, Nyamira County, Kenya

1.3.2 Specific objectives

1. To establish the influence of financial data collection on the financial performance of SMEs in NyamiraTown, Kenya.
2. To investigate the influence offinancial data recordingon the financial performance of SMEs in NyamiraTown, Kenya.
3. To determine the influence of financial data analysison the financial performance of SMEs in NyamiraTown, Kenya.

II. LITERATURE REVIEW

2.1 Theoretical Review

2.1.1 The Theory of the Firm

According to Williamson (1964),the theory of the firm has number of economic theories that expoundabout firmssuch as the behavior of the firm, why it exists and its relationship with market. Different economists have investigated the traditional and modern models so that to find out if any of the models is able to justify the theory. Curwen pursued a theory that was able to illustrate the behavior of firms in an economy regardless their size and the degree of competition the firm faces. (Curwen, 2015). Whilst there are restrictions when trying to achieve for instance the general theory can be applied in all areas of the firm, although most economic models have stressed the assumption of profit maximization.For business to have a successful entity mostly for small business entity, it is important to consider crucial financial decisions. Most of the decisions are related to capital sourcing and ensuring capital is well used to ensure growth and profitability of the business. For the above objective to be achieved it is important for business to have proper accounting skills and management.

2.1.2 The Theory of Entrepreneurship

Individuals and firms in economic theory to refer to market equilibrium and innovative events that are done in uncertain conditions use entrepreneurship term. Therefore, the term entrepreneurship is used fully in economic literature and most economic theories fail to be articulate it in their model (Adaman and Devine, 2010).According to Wood (2005) state that most of the economist stressed on different aspects of entrepreneurship and making their contribution towardsacceptingof entrepreneurship. Kirzner, asserted in his research that entrepreneurs act has economic agents who repair disequilibrium in any county achieving equilibrium (Kirzner, 2013). He goes further highlighting that equilibrating in entrepreneurship can be stated by the profit opportunities that exist in market that is not equilibrium. Entrepreneurs discover the profit opportunities and act on them, thereby resulting into market being returned into equilibrium.Thetheory of Entrepreneurshipexplains the significanceof entrepreneurship and is arecognized model that is well used by economists. Although of the difficulties and weaknesses of the theory is that it assumes that all businesspersons have the same information and resources that transform to equal opportunities and ready for all entrepreneurs (Holcombe, 2013, p25).

2.1.3 Financial Sustainability Theory

There should be sustainability and long –term survival for MFI so that to reach the clientele and make sure it covers administrative and other costs. Social goals should be able to reach the poorest and ensure there is poverty mitigation are valid, ensuring there is sustainable standing on one’s own feet for the true low income households that is able to receive microfinance. For Microfinance to be sustainable there should be internal and external implications. Internal refers to deposit and savings utilization, staff motivation, financial performance and administrative costs etc. on the other hand external refers to the availability of funds for loan disbursement and grants given to the community etc.(Morduch, 2012).

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2.2Conceptual Framework

INDEPENDENT VARIABLE **DEPENDENT VARIABLE**

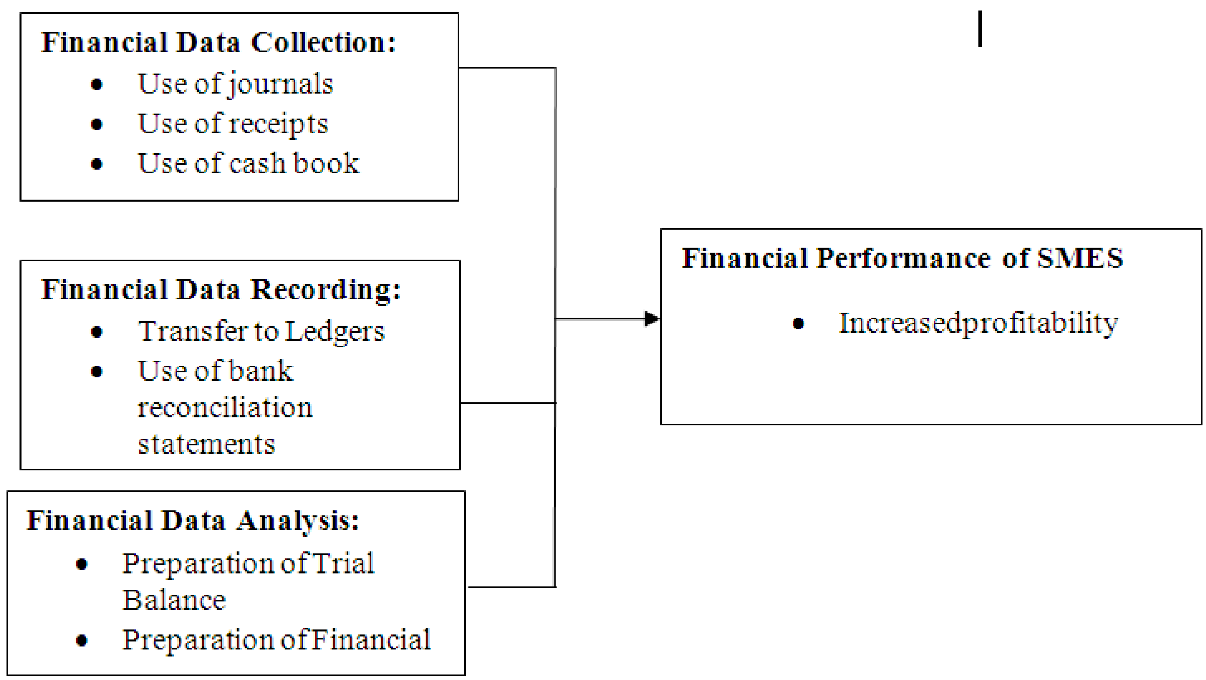

Fig 2.1: Conceptual Framework

2.3 Empirical Review

D'Amboise and Gasse (2015) examined how small manufacturers use financial statement analysis in Quebec Canada. It was established that small manufacturers in plastic and shoe industries do analysis based on fiscalstatements and it was found thatmanagement decisions in manufacturing firms mostly depend on financial reports that are prepared by accountants.

On the other handDeThomas and Fredenberger (2005) established that 81% of SMEs usually obtain summary of financial information and 91 percent of the information is financial statements that included financial statements, and balance sheets.Bank reconciliation is the remainder which business is not operating at cash –flow information regularly. It was further established 61 percent of the participants felt that financial statements provide them with information that is needed for decision making and planning. Hence, 11 percent of the participants revealed that financial statement information are used to for managerial evaluation decision making and planning and lastly 2 percent of the firms utilize the use of financial ratio analysis making it simple for historical comparisons.

DeThomas and Fredenberger's (2005) found that 96% of the firms prepare compressive statements and it is the obligation of the business to evaluate and use the information it has being service given making only 4 percent to depend on information given outside accountant services.According Farhoodman and Hryck (2005) who did a survey in 69 SMEs on importance of computers across USA and established that accounting practiceswas rated with the highest percentage. On the other hand, Palmer (2011) was able to interview 36 managers who own small retails and owners and 33 percent of industries use accounting soft wares. From previous research show that financial management and accounting applications rule the use of computers in SMEs in North America in 1990 to 2015.

According to Druny and Tayles (2015) argue that same procedures and rules that are recognized for peripheralare used in organizational reporting for example management accounting. Internal and external reporting incline the similar rules, therefore management accounting is not a compliant of financial accounting. Most businesses adopt same practices that are used reporting systems so that the companies can have their internal profit will be reported constantly with the financialaccounting requirements so that to be equivalent with the outsiders' assessments of the overall performance of the company.Companies should ensure that there is no conflict that arises between internal accounting systems and external accounting requirements.

Szychta (2012)conducted a study on manufacturing and service enterprises in Poland where it was concerned with management accounting practice on budgeting. It was established that small firms makeyearly financial budgets operating the whole firm. Small proportion of enterprises prepares a complete master of budget and the rest prepare sales, cost budgets and production. Dissimilar Polish companies, Japanese firms are not very extensive in the use of financial budgeting (Yoshikawa, et al., 2013). Internal reportsare usually prepared monthly and annually as thekey issues are included inside the reports. Due to ineffective budgeting and reporting systems as indicated by most companies fail do adopt accounting information thoroughly without clear definition and its purpose (Haldma and Laats, 2012).

III. RESEARCH METHODOLOGY

3.1 Research Design

The above study embraced descriptive survey research design. Kothari (2004), descriptive research design is used mostly when a problem is well defined and the researcher wants certain subjects to be described by the participants about the research problem. Similarly,Ngechu (2004) argue that survey designs are accurate in descriptive studies and generalize results. Single group of respondents in cross sectional survey is usually identified at a single point in time

3.2 Target Population

This study was conducted in Nyamira town and targetedowners of the 550 registered SMEsin the town.

3.3Sample Procedure and Sample Size

The researcher selected a number of respondents, subjects from the population to come up with a sample based on a formula suggested by Mugenda and Mugenda (2003) who suggested a sample of between 10 to 30% of the population. Since the population was relatively large, a sample of 10% of the population was taken. Random sampling, which reduces the frequencyof sampling error in the population hence increasing the accuracy of any method used in estimation, was used to select the 55 SMEs.

3.4 Data Collection Instruments

For the present study, questionnaires were used to collect the primary data. The researcher had to gather primary data from respondents directly using questionnaire for the above study. The data collected using questionnaire was quantitative while some of the questions were open ended. Therefore, the researcher used questionnaire to collect information.

3.5 Data Processing and Analysis

The researcher analysed data using descriptive analysis. The data collected wassystematically organized to facilitate analysis. The information collected was described using descriptive statistics that will include percentages, tables and frequencies. The data was analysed by use of computer Programme software.Pearson's correlation analysis and regression analysiswereusedfor the hypotheses testing

Regression Model

$$Y_0 = \beta_0 + \beta_1 (Z_1) + \beta_2 (Z_2) + \beta_3 (Z_3)$$

The variables are explained below:

Y_0- Financial Performance(Level of Profitability)

Z_1- Financial Data Collection

Z_2- Financial Data Recording

Z_3- Financial Data Analysis

IV. RESULTS AND DISCUSSION

4.1 Response Rate

There were 55 SMEs respondents expected to fill the questionnaires but only 45 did constituting a84% response rate. The remaining 10 respondents did not answer the questions as they were either too busy or flatly refused to answer for personal reasons.

4.2 Inferential Analysis

The study employed a summated Pearson's Moment of Correlations and regression analyses. The results are presented below

4.2.1 Correlation Analysis

Pearson correlation analysis was done for the study involving both the predictor and independent Variable. Table 1influence of financial data collection, financial data recording and financial data analysis the financial performance of SMEs in Nyamira County where FP represents financial performance, FDA is Financial Data Collection, FDR is Financial Data Recording and FDA in Financial Data Analysis.

Table 1: Correlations

	FP	**FDC**	**FDR**	**FDA**
FP	1			
FDC	.655**	1		
FDR	.635**	533**	1	
FDA	.710**	.205**	.198	1

**** p< .05**

Pearson correlation analysis was done to find out the relationship between the predictor and dependent variables, in which the measurements were done using mean scales. Correlation analysis value usually range from 0.10 to 0.29 which is weak, 0.30 to 0.49 is medium and lastly 0.50 to1.0 is strong (Cooper & Schindler 2000).On the other hand Field (2015) states that when analyzing correlation the coefficient should not be above 0.8 so that to avoid multicollinearity In

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the above study the correlation coefficient was 0.710 that was less than 0.8 meaning there was no multicollinearity as shown on table 1.

From the study there was positive correlation between independent variables and dependent variables with supplier payments of invoice that are maximum correlation of ($r=0.710$, $p< 0.01$) followed by book keeping with a correlation of ($r=0.655$ $p< 0.01$) and then accounting information systems with a correlation of ($r=0.635$ $p< 0.01$).It shows that all the variables are statistically significant at the 99% confidence interval level 2-tailed indicating that independent and dependent variable have positive relationship.

4.2.2 Regression Analysis

Regression analysis was used because all the primary constructs in measurement of the model were quantitative in scale. Regression analysis is a method that is used to determine the ability of independent variable so that to predict the dependent variables
As part of the analysis, Regression Analysis was done. Table 2 shows the results.

Table 2 Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.882[a]	.779	.841	.176

a. Predictors: (Constant), Financial Data Collection, Financial Data Recording and Financial Data Analysis

b. Dependent Variable: Financial Performance

From table 2 there was positive direction of the results since R was .882. Wong and Hiew, (2005) argues that R is a correlation of the observed vice versa the predicted values in the dependent variable to find out the correlation. R sign can either give a positive or negative relationship and the absolute value of R shows the strength in which when R has high absolute value it means strong relationship. From the results,R-value was .882 showed a strong relationship of the observed and predicted values hence positive direction. R^2 value was 0.778 that stands for coefficient of determination that indicate that 77.9% is explained by the variables while 22.1% is unexplained.

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	232.743	4	43.096	64.904	.000[a]
	Residual	12.878	40	.664		
	Total	244.511	44			

a. Predictors: (Constant), Financial Data Collection, Financial Data Recording and Financial Data Analysis

b. Dependent Variable: Financial Performance

From the table above the F-statistics was 64.096 making it to be significant at 5% (Sig. F< 0.05),this shows the suitability of the model and there is a statistically significant relationship between Financial Data Collection, Financial Data Recording and Financial Data Analysis, and Financial Performance of SMEs.

Table 4Coefficients

Model		**Unstandardized Coefficients**		**Standardized Coefficients**		
		B	**Std. Error**	**Beta**	**t**	**Sig.**
1	(Constant)	2.767	.361	.287	7.668	.000
	Financial Data Collection	.385	.078	.393	4.968	.000
	Financial Data Recording	.168	.065	.193	2.584	.004
	Financial Data Analyzing	.329	.064	.352	5.140	.000

a. Dependent Variable: Financial Performance

The t-value of constant produced (t = 7.668) was significant at .000 per cent level (Sig. F< 0.05), thus confirming the fitness of the model. Therefore, there is statistically significant relationship between book keeping, accounting information systems, supplier payments of invoice and

Financial Performance of SMEs.From the findings the results indicate that all the variables are statistically significant since the P value was less than 5%.Itis indicated below on the model as:

$$\mathbf{Y_0 = 2.767 + 0.385\ (Z_1) + 0.168\ (Z_2) + 0.329\ (Z_4)}$$

This indicates that all the three variables of accounting practices positively and significantly predict financial performance of the SMEs. This is confirmed by the beta values of (β = 0.385, p = 0.00), (β = 0.168, p = 0.04) and (β = 0.328, p = 0.00) for Financial Data Collection, Financial Data Recording and Financial Data Analysis respectively. The implication is that when Financial Data collection is improved by a unit, financial performance in the tea factories significantly improves by 38.5% when all other factors are held constant. Similarly, when all other factors are held constant, a unit increase in Financial Data Recording leads to a 16.8% significant increase in financial performance in the SMEs. Additionally, it can be concluded that a unit increase in Financial Data Analysis leads to a 32.8% increase in financial performance holding all other factors constant.

V. CONCLUSIONS AND RECOMMENDATIONS

The following are the conclusion were drawn from the findingsThe first objective, therefore, there were no proper recording of transactions which consequently had a significant influence on the financial performance of SMEs in Nyamira County, Kenya. Financial Data Collection has a significant positive influence on financial performance of the SMEs. Based on the second objective, therefore, there was no use of proper accounting information systems which consequently had a significant influence on the financial performance of SMEs in Nyamira County, Kenya. Financial Data Collection has a significant positive influence on financial performance of the SMEs.Based on the third objective, therefore, there was no analysis of the financial data which consequently had a significant influence on the financial performance of SMEs in Nyamira County, Kenya. The influence of financial data analysis of financial performance of the SMEs was found to be positive and significant.

The SMEs owners and managers should engage in some elementary accounting training to enable them engage in book keeping to help them improve their financial performance. The SMEs owners and managers should invest in accounting information systems to ease and make it possible for effective and full accounting recordings to help improve their financial performance. The SMEs owners and managers should improve on their financial data analysis to avoid unscrupulous dealings and allow for effective accounting practices to help improve their financial performance.The government should initiate policies that would make it mandatory for SMEs to have an accounting policy to help build the process and curb corruption in the process.

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