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# FINANCIAL PLANNING STRATEGIES AND THEIR INFLUENCE ON THE GROWTH OF INVESTMENTS AMONG SMALL AND MICRO ENTERPRISES IN NAKURU TOWN, KENYA

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**Abstract**
*The contribution of the Small and Micro enterprises (SMEs) to the Kenya economy cannot be ignored. However close to one million small enterprises are established each year, with at least 96% will be closed by their 10th year. This study sought to assess the influence financial planning strategies has on growth of investments among small and micro enterprises in Nakuru town, Kenya. The study targeted all SMEs within Nakuru town with owners or managers as the respondents. A survey design was used with a sample of 70 SMEs selected using stratified random sampling methods. Descriptive statistics provided a clear description the variables while multiple regression analysis was also used to analyze the relationship between the financial planning strategies and the growth of SMEs. The findings revealed that most SMEs had adopted several financial planning strategies with cash flow planning, investment planning and capital planning strategies significantly influencing SME's Return on Investments. The study recommends SMEs to deepen their financial planning strategies and align them with their returns on investment goals.*

*Keywords: Financial planning strategies, Growth in Investments, Small & Micro enterprises, Cash flow planning, Investment planning, Capital Planning, Risk Planning*

## INTRODUCTION

The growth of Small and Micro enterprises in the last couple of decades has revolutionized the manner in which trade is conducted across the world and has the global economy (Mephokee, 2004). As the principal driving force of economic development, they continue to be a source of sustained growth in almost all countries globally making it a core focus in global agenda (Garikai, 2011). The emergence SMEs at the top of economic agenda arises from the fact that they are a major source of employment, domestic and export earnings, an instrument in poverty reduction and a catalyst for growth in under developed and developing economies (Mephokee, 2004). By the end of 2009, the SMEs sector in Kenya had 7.5 million registered SMEs providing both employment and income generation opportunities to both young and old entrepreneurs. In 1993, the sectors contribution to the Gross Domestic Product (GDP) stood at 13.8 per cent significantly increasing to over 40 per cent in 2008 creating over 92% of the new jobs (GOK, 2009).

Despite the role played by SMEs and the hope that it is envisaged to bring, research shows that SMEs encounter a range of problems and even though close to one million small enterprises are established each year of the small enterprises established in a year, at least 40% of them close within one year and 80% of them will be out of business within 5 years and 96% will be closed by their 10$^{th}$ year (Gerber, 2001). This denotes a serious challenge to the Sector calling for unified interventions to change the trend. As noted by Ngugi, (2013), most of the challenges that face SMEs impeding their growth include lack of capital, poor managerial experience, lack of capacity to respond to emerging challenges and poor planning.

According to Gerber (2001) financial planning is a continuous process that seeks to direct and allocate financial resources towards the attainment of strategic goals of an enterprise. The result of any financial planning process is a defined financial plan and a guiding tool for revenue and expenditure usually in the form of budgets. Financial planning encompasses a number of considerations in its formulation that must be considered based on the objectives and the context in which planning takes place. Maintenance of optimal cash levels sets the foundation on which the business can minimize liquidity risks while maximizing on its income generating abilities by minimizing idle financial resources. Gerber (2001) recommends that cash flow optimization must be a core objective in any financial planning process given its influence on other financial performance outcomes. Investment choices have a great potential of generating either a positive or a negative impact on an enterprise. Where investments are not aligned with cash flow projections and cost of capital the likelihood for negative returns increases significantly (Defond & Hung, 2003). Failure to develop and effective financial plan opens up uncertainty that unduly increases the vulnerability of an enterprise to both internal and external shocks.

In Kenya SMEs operate in all sectors of the economy extending from manufacturing, trade to the diversified service subsector. The SMEs enterprises range from those unregistered, known as “Jua Kali”, to those formally registered small-scale businesses, such as supermarkets, wholesale shops, hospitals, restaurants etc. The capital invested in SMEs varies from as little as ten thousand Kenyan shillings to about 5 million Kenyan shillings. Almost two-thirds of all SMEs in Kenya are located in either peri-urban or rural areas, one-third of which are formally registered and have formal management structures are found in the urban areas (KNBS, 2007).

Close to 70 per cent of the SMEs are in the trade sector more often engaged in buying and selling goods and services as a key source of their income. Nationally, by the close of 2015, SMEs in the manufacturing sub-sector accounted for 13 per cent, SMEs in the services sub-sector accounted for 15 per cent, the collective group of other service providers, such as bars, hotels and restaurants (Hospitality industry) accounted for 6 per cent. Enterprises in the construction industry accounted for less than two per cent of the total SMEs in the country (Central Bureau of Statistics, 2016). If Kenya is to become competitive through growth of the private sector, it is inevitable that more attention must be directed towards addressing the key bottlenecks impeding SME growth and competitiveness (KNBS, 2007). Good financial management practices have been viewed as critical elements in the success of SMEs in developing countries. However, despite this recognition most SMEs continue to show poor financial performance leading to closure or remain stagnant calling for a working intervention.

Financial planning remains to be a very important survival tool for business intending to make any significant growth especially among Small and Micro Enterprises facing capital limitations and hostile operating environment. According to Waweru (2007), lack of budgeting and financial discipline remains to be a key source of failure or poor financial performance of SMEs in Kenya. Gibson and Cassar (2002) notes that the management and key decision makers of smaller firms have little or no understanding of the financial planning strategies due to lower educational levels, compromising on their profitability and growth. With over 70% failure rate among SMEs in their first three years of existence, adoption of the right financial planning strategies remains to be the most critical solution. However, with a high investment in SME by both the government and non-governmental agencies on financial management practices, the continued trend of failure is least justified putting into question, the effectiveness of their financial planning strategies. If growth and largeness reduce failure, then there is need for concerted efforts in finding the effects of the financial planning strategies adopted by SMEs on the growth of their investments, the essence on which this study sought to establish.

## RESEARCH METHOD

The study adopted a quantitative approach based on a survey design. The choice of the research design was based on the need to collect views from a sample of SMEs taken to represent the entire population through measuring a set of variables as they exist naturally as a means to describing the phenomena under investigation. The target population comprised of all 242 SME licensed by the County government of Nakuru to operate with Nakuru town central Business District (CBD) in the year 2016. The SMEs comprised of supermarkets, Hardware stores, Hotels & restaurants, Agro vets, Chemists, Private Collages, Clothing Store, Bookshops and Car bazaar. The manager or the owner of the business was the target respondent taking into consideration that they are knowledgeable and participates in financial planning in the firm. Based on the sampling formula proposed by Naissuma (2000), a sample size of 70 respondents was selected using stratified random sampling method. A researcher designed closed ended questionnaire with specific sections addressing; cash flow planning strategies, investment planning strategies, financial risk planning strategies and capital planning strategies was used. A five point Likert type questions were used. Mean and standard deviation of the scale scores were computed to establish a description of respondents attributes while inferential analysis based on multiple regressions was used to establish the influence that individual financial planning strategies on investment growth. T tests were used in establishing the significance of the coefficients and as a means of testing the hypothesized influence of the financial management strategies on SME's Growth in Investments.

## ANALYSIS AND FINDINGS

From a total of 82% (n = 58) managers and owners of SMEs who responded in the study, 77% had a formal and documented financial plan for their business, an indication of the increased acceptance by SMEs of the formalization of their financial planning. The overall responsibility of financial planning were assigned mainly to the owners (44%) followed by financial planning teams (21%) and the hired managers (19%). The review of financial plan was mainly done on annual basis and semi-annually. This points towards a potential shift from the past where SME owners were less involved in financial planning as a result of their low educational levels and financial management literacy as found out by Kono & Barnes (2010). More to this, there is a general recognition of the engagement of financial planning experts and teams work in financial planning effort by SMEs, a deviation from previous owner controlled approach.

### Cash planning strategies

The cash management strategies adopted by most SMEs were composite in nature blending multiple strategies in an effort to maintain optimum cash positions. Based on likert scale with a rating of 5 indicating the highest level of importance against 1 for the least importance, the respondents rating on six core cash management strategies were as indicated in Table 1.

Table 1: Respondent's ranking on Cash flow planning strategies

| **Aspects of cash flow management consider important** (n = 58) | **Mean** | **SD** |
|---|---|---|
| Maintaining adequate cash balances in the bank account. | 3.53 | 0.654 |
| Investing any idle cash. | 2.82 | 0.887 |
| Balancing cash receipts and cash payments | 3.77 | 0.224 |
| Selling on cash basis only. | 3.07 | 0.772 |
| Having a stand by bank overdraft facility with banks/lenders. | 4.09 | 0.221 |
| Timing all cash inflows to coincide with cash outflows. | 3.66 | 0.452 |

Having a bank overdraft facility was dominant cash planning strategy followed closely by the intentional plan to balance cash receipts with period cash payments. The dominance of these two cash flow planning strategies points towards a more recognition that reducing the time cash is tied up in the operating cycle improves a business's profitability, returns on investments and overall business performance as noted in the findings of Ross et al.(2011). There was a notable lower preference for investment of any idle cash and selling on cash basis as a strategy, more likely attributed to the un certainty that exist in the SMEs sector calling for a significant cash balance to cover for less favorable cash flow seasons. This is also consistent with the view of Opler et al (1999) arguments in reinforcing the justification that management accumulates excess cash if it has the opportunity to do so more often on a precautionary motive.

**Investment Planning Strategies**

An evaluation of investment planning strategies reveals the presence of mixed approaches as seen in Table 2. The investment planning strategies was dominated by differentiation of the short term and long term strategies when planning for investments. This was followed by a diversified approach in planning investments as a means to developing a diversified investment portfolio. The segregation of short term investments from long term investments, as the core investment strategy is in line with the findings of Opler et al (1999) reveling that the differences in the cost of investments and policies defined the choice of investments among Small businesses.

Table 2: Investment planning Strategies

| **Core investment planning strategies considered** (n = 58) | **Mean** | **SD** |
|---|---|---|
| Investments planning based on long term vision/goals | 3.53 | 0.654 |
| A progressively interlinked investment planning strategies | 2.82 | 0.887 |
| Diversified investment planning strategy | 3.77 | 0.224 |
| Advance capital acquisition with every investment plan | 3.47 | 0.772 |
| Different short and long term strategy for our investments | 4.09 | 0.221 |

A Notable number of the SMEs had their investments planning strategies driven by the business long term vision or goals. However, the use of progressive and interlinked strategies in planning for long term investment was the least popular with the SMEs. This is closely linked to the uncertainty in the SMEs operating environment putting more investment goals within the short term as a matter of survival rather than growth. As noted by Debelak (1997), it is more likely in such an environment of uncertainty, forward thinking provides the anchoring for the current planning, while moving towards the defined goal could be fragmented through suitability of investment solutions available in the short term and availability of optimal financing sources.

### Capital Planning Strategies

Considering capital as a core component of enterprise growth, four strategies were presented to the respondents as indicated in Table 3 to determine their use and preference. Strategic selection of the sources of capital was the most widely used capital planning strategy followed by investment capital matching, mainly centered on the desire to ensuring that the capital planning process places the intended capital in most valued investment.

Table 3: Respondents Views on the Capital Planning Strategies

| **Nature of the capital strategy** (n = 58) | **Mean** | **SD** |
|---|---|---|
| Strategic selection of the sources of capital | 4.14 | 0.333 |
| Strategic debt- equity capital ratio planning | 3.03 | 0.454 |
| Investment- Capital Matching | 4.02 | 0.517 |
| Capital planning based on cost of capital | 3.07 | 0.564 |

The balancing of debt and equity in the capital structure and capital planning based on minimizing cost of capital were least considered as capital planning strategies by SMEs. While the financial leverage concept is highly utilized in large corporates, this seems to be less entrenched among SMEs in the current study. More so as postulated by Gveroski & Jankuloska (2017), majority of small businesses, in their early stages of development, usually rely on their own sources of funding can be seen as the a core reason

### Risk Planning Strategies

Risk planning is critical for SMEs who are in constant exposure to market, competitive, liquidity and management risks emanating from both their internal and external environment. As seen in Table 4, the choices of the risk planning strategy by the reviewed SMEs were strongly centered on risk minimization, avoidance and prioritization strategy. Insurance however was not considered by most of the SMEs.

Table 4: Financial risk planning strategies employed by SMEs

| **Components of the risk planning strategy** (n = 58) | **Mean** | **SD** |
|---|---|---|
| Prioritized Risk analysis in financial planning activities | 4.04 | 0.333 |
| Insurance against risks | 3.03 | 0.454 |
| Risk avoidance strategy in all financial plans | 4.12 | 0.517 |
| Risk minimization in our key financial planning | 4.27 | 0.564 |
| Risk eliminating strategy in financial planning | 2.87 | 0.972 |

The findings points towards a significant recognition by SME owners and managers of the importance of proactive risk management and its embedment into the formal planning processes. Risk minimization and avoidance remains to be the most preferred strategies for two reasons; they are the less costly and the most practical approach given the limited financial capability most SMEs face, a similar view held by Madembu & Namusonge (2015)

Given the diversity of the strategies adopted by different SMEs, It was in the interest of this paper to also explore how the different strategies were influencing growth of investments. Using the total likert scale score of the different elements examined in each strategy and SMEs rating on their growth as measured by their return on investments, a linear regression model was used upon affirmation of the necessary assumptions on linearity, homoscedasticity and normality of error distribution (Table 5).

Table 5: Regression Analysis Results

| | **B** | **Std B** | **Std. Err.** | **T** | **P > t** | **VIF** |
|---|---|---|---|---|---|---|
| Constant | 3.398 | | 2.13 | 1.59 | 0.118 | |
| Cash Flow planning strategies | 0.189 | 0.29 | 0.074 | 2.53 | 0.015 | 1.20 |
| Investment planning strategies | 0.196 | 0.26 | 0.081 | 2.42 | 0.019 | 1.18 |
| Risk planning strategies | 0.125 | 0.15 | 0.090 | 1.39 | 0.171 | 1.09 |
| Capital Planning strategies | 0.184 | 0.27 | 0.079 | 2.31 | 0.025 | 1.09 |

*Independent Variable; Return on Investment, Number of observations = 58*

*F ( 4, 53) = 9.25, Prob > = 0.0000, R-squared = 0.411, Adj R-squared = 0.367.*

All the four strategies significantly explained 41.1% ($R^2$ =0.411) of the variations in in the return on investments of the SMEs (F = 0.411, df = 53, $p$ = 0.000). Cash flow, investment and capital planning and not risk planning were found to be significantly influencing the growth in investments of SMEs in Nakuru town. The insignificant contribution of the risk planning strategies to the return in investments rests on two underpinning relationships with the other strategies. First, where cash flow, investments and capital planning strategies are prudent and effectively implemented, less risk will be abound leading to minimal influence on the overall returns in investments. Secondly, risk planning, critically is inherent in the other three strategies that is in cash flow, investment and capital planning, risk is a key underpinning both analysis and the choice of the strategy to be selected.

## CONCLUSION

From the findings of this study; four conclusions were arrived at that forms a views critical to enhance understanding of SMEs financial planning systems; first, SMEs are progressively recognizing the critical role that strategic financial planning in defining the levels of returns in investments achieved. Secondly, SMEs remains defensive and continues to employ strategies that protects their liquidity rather than aggressive deployments of cash flows for improved returns. Thirdly, investment planning is segregated into short and long term coupled with diversifications limiting risk exposure. Finally, there is a preference for aligning the sources of capital and the intended investments among the SMEs, an increased recognition of the need to allocate capital to return maximizing opportunities. With the scope of this study limited to financial planning strategies and their influence of Returns on investment, and shift from traditionally owner centered financial planning in SMEs, calls for further research to explore the influence that team approach and financial professional currently gaining recognition in financial planning has on the returns of SMEs.

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