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Influence of Financial Management Practices on Performance of Small and Medium Enterprises in Kitale Town, Trans-Nzoia County, Kenya

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Abstract:

In Kitale town, many SMEs are performing poorly due to poor financial management practices, yet they occupy a large part of the Trans-Nzoia County economy. If this situation is not addressed, their contribution to the economy will likely be affected. It was found that the growth rate of Kenyan small and medium-sized enterprises (SMEs) decreased from 5.4% in 2011 to 4.3% in 2013. Unemployment is a direct result of a drop in performance, and unemployment exacerbates social inequities and criminal activity. Because of this, this research examined the effect of financial management techniques on the performance of small and medium-sized firms (SMEs) in Kitale town, Trans-Nzoia County, Kenya. This study employed a descriptive research design. In this study, the target population comprised all the managers of retail shops/stalls, butcherries, hardware, and small hotels/cafeterias. Using Gay's criteria, the researcher selected a total of 45 respondents based in Kitale Town. The research instruments used included questionnaires. Data for this study was edited, loaded, and then analyzed descriptively to avoid errors by using frequency lowest, mean scores, and percentages. In addition, inferential statistics were applied using the general linear model-ANOVA and robust standard error regression using SPSS V20 statistical package. The results of the study were presented in the form of tables and figures. It was determined that the response rate was 99.2 percent, with 125 people picked using a basic random selection procedure, with data acquired via the use of questionnaires. Three key financial management methods followed by SMEs were identified in the research, all of which were determined to have a beneficial impact on the performance of small and medium-sized businesses. A rise in these factors will lead to a rise in the company's profits. Financial performance may be predicted at any given moment due to the considerable impact of this study. Moderate levels of adoption of financial management strategies show they have not yet been fully employed in order to enhance performance. Therefore, managers and owners of small businesses are urged to prioritize the use of financial management procedures. When it comes to financial management, they should not only devise a strategy but also regularly monitor and analyze its effectiveness. A number of recommendations are made in the report. It was decided to focus on just Kitale County's small businesses, to begin with. It is possible that this is not a true picture of SMEs throughout the nation.

Keywords: Financial management practices, small and medium-sized firms, Kitale town

1. Background to the Study

Globally, small and medium-sized enterprises (SMEs) are the building blocks of an economy since they play a significant role in encouraging development, innovation, and prosperity and contribute up to 33% of GDP in developing nations (Dalberg, 2011) (World Bank, 2015). Entrepreneurs have a wide range of choices, from how much money to raise to what parts of the firm to invest in. They have a tendency to make blunders when it comes to management. Entrepreneurs are susceptible to a variety of prejudices since they are human people. Because of their blunders, they may not be able to make the best decisions. Fund collection and distribution, savings and consumption, mortgages, and even risk assessment and management may all have an impact on the profitability of small- and medium-sized enterprises.

According to Jindrichovska (2013), European researchers studied the link between the default behavior of small businesses and the credit characteristics of their owners. SME credit risk should be assessed differently from that of big firms to make SMEs seem more directly and substantially influenced by their owners so that a more acceptable and effective method of credit management for SMEs can be implemented in reality.

In South Africa, Fatoki (2012) has researched the financial management methods of new micro businesses. Finance, accounting, investment evaluation, and working capital management were among the areas he concentrated on throughout his career. According to the research, small business financial management practices are relatively inadequate in areas such as financial planning, analysis, control, and investment choices. As a result, the researchers concluded that financial management, e-accounting, and investment choice assessment training should be provided.

Financial management practices in Kenya have been studied by (Waweru & Ngugi, 2014), who conducted a study on the financial practices of micro and small firms in Kenya. For the first time in Kenya's history, a case study of a small business in the slums of Kibera demonstrated that the management of financial procedures is a significant aspect of the success of small businesses. A study in Kitale town in Trans-Nzoia County examines how financial management methods affect SMEs' performance to fill the research gap that previously existed. Financial management is one of the biggest issues for small and medium-sized businesses (SMEs). A lack of understanding of financial management procedures, coupled with the instability of the economic climate, may result in major financial difficulties for small and medium-sized enterprises.

2. Statement of the Problem

Many small and medium-sized enterprises (SMEs) in Kitale town are underperforming because of inadequate financial management systems, even though they account for a significant portion of the Trans-Nzoia County economy. If this problem is not resolved, the SMEs' economic contribution will be negatively affected (Mole & Namusonge, 2016). Around 80% to 90% of SMEs fail within 5-10 years, according to Ahmad et al. (2011). The growth of Kenyan small and medium-sized enterprises (SMEs) decreased from 5.4 percent in 2011 to 4.3 percent in 2013, according to the Kenya Economic Survey 2013. Because of this fall in performance, Kenya's unemployment rate has risen, leading to social inequities and criminality (Njagi, Maina, & Kariuki, 2017). A further empirical question is how to deal with the bimodal distribution of enterprises, of which 59% are MSEs, 16% are medium-sized businesses, and 23% are large-sized businesses (Waweru & Ngugi, 2014). Small and medium-sized businesses (SMEs) make up the majority of the economy in third-world nations, although their poor performance has gone unaddressed for decades (Brigham, 2002). Financial management methods, on the other hand, have a significant impact on SMEs' poor company performance, according to research from industrialized countries. Tushabomwe - Kazooba (2006) discovered in previous research that small and medium-sized enterprises (SMEs) are not functioning up to expectations and that their contribution to the economy would be harmed if this issue is not addressed.

Wanyungu (2001) and Mulehi (2013), both of whom studied financial management practices in Kenyan small firms, have done research on financial management practices in Kenya. Local studies have never examined financial management techniques in micro and small businesses throughout Kenya. Accordingly, the present research aims to close a knowledge gap by looking at how well-managed small and medium (SME) businesses in Trans-Nzoia County's Kitale town handle their finances. Financial management is now a difficulty for small and medium-sized businesses. Small and medium-sized businesses typically have major financial performance issues because of a lack of financial management expertise and the general lack of predictability in the business environment. Owner-managed or hired, the business's success will be negatively impacted if financial choices are made incorrectly. SME profitability might be negatively affected because of poor financial management. Many small businesses have failed because they lack an understanding of how to handle their finances properly. In addition, SMEs' reliance on equity and high liquidity because of the business environment's volatility and undercapitalization likely affect the profitability of small and medium-sized enterprises (SMEs) (Nguyen, 2001). Financial management techniques seem to have harmed the performance of small and medium-sized enterprises (SMEs) operating in Kitale.

3. Literature Review

One of the crucial aspects of financial management is financial planning (budgeting), which mostly involves a rigorous process of monitoring finance regularly (Brown et al., 2005). As one prepares the budget, the person does it as per the finance available. This process involves an assessment of the financial situation using other financial statements (Lusardi & Mitchell, 2007). Muchiri (2017) studied practices of financial management and the performance of finance of firms (non-financial) at Kenya's NSE. The variables were liquidity, capital budgeting, and advantage. They focused on the connection between the management of finance and the performance of finance of these firms. Data were collected using the analyzed data by panels, and a census study was done on the concerned firms. It used secondary data from 34 companies for a 5-year period covering 2010-2014. The findings were that proper liquidity management and proper capital budgeting can bring about higher profitability.

As one makes these decisions, one needs to assess the current situation of their finance, which will assist one in establishing their financial objectives. Later, outline the course of action to be followed to attain the goals by evaluating several alternatives. Lastly, one needs to do a review of the initial financial plan to see if it is performing in accordance with what was expected.

In addition to direct cost, capital structure imposes a burden on the SMEs regarding the cost of complying with the tax laws. This includes costs of complying with other costs, including labor, environment, and safety regulations. A number of factors influence capital structure. In addition, there are changes in tax rules, a complicated tax system, various tax authorities, ambiguous tax laws, several deadlines for compliance with tax laws, and the expense of an external tax provider. The tax system should be tailored to the specific circumstances of the SMEs, Yang (2017).

A cash flow forecast is a financial statement that attempts to depict how cash is projected to flow in and out of a company over a period of time in the future. A cash flow prediction is used to determine if predicted cash revenues

(inflows) will be enough to meet projected cash outflows (outflows). Even if a company is prosperous, it might run out of funds. An investment banker may say, 'Cash flow estimates give the information required to prevent liquidity concerns.' In other words, a cash flow prediction is a tool for managing cash so that you can pay your invoices on time and keep your firm running.

A cash flow forecast is a useful tool for determining sales targets and budgeting for spending related to those targets. A projection may also be used to calculate the breakeven point during a start-up or growth phase. A cash flow forecast is an excellent tool to use while planning a significant investment, such as an equipment purchase or a transfer to a new site. A forecast may also assist a seasonal firm with substantial inventory purchases to have the funds on hand to undertake a large inventory investment when necessary.

4. Research Methodology

In this study, a descriptive research design was deemed acceptable, as it aims to describe a problem utilizing a variety of responses and model a remedy. The target population comprised all the 125 managers of the retail shops/stalls, butcherries, hardware, and cafeterias/small hotels. In this study, the census technique was used. This is because the target population was found to be small and suitable, and reducing it would tamper with the findings of the study or render the study incomplete. Hence, the sample size for the study was the same as the target population of 125.

The research instruments used were questionnaires. They were used because:

- They capture a greater depth of responses,
- They contain both structured and unstructured questions, which were filled in by all respondents

The researcher judged this study legitimate since the required answers were obtained from the sample population. Individual observations were used whereby the researcher recorded the desired information by first defining the behavior to be observed and then developing a detailed list and thus were able to make appropriate notes about the salient features. The researcher also contacted subject experts from the school of business, i.e., the lecturers, to ascertain the validity of the research instruments and advice. The questions were developed with the guidance of research objectives and research questions. Finally, the researcher studied the relevant literature, e.g., scholarly journals and books of renowned authors, to determine the true findings and how well the findings reflect reality.

Analysis of correlations between study items and the data collection instrument was done using Cronbach's Alpha to determine the instrument's reliability. Cronbach Alpha values for financial performance were 0.714, 0.826 for capital budgeting procedures, 0.777 for capital structure practices, 0.73 for financing practices, and 0.717 for SME size. According to the Cronbach Alpha values, the research instrument was reliable and valid since all of the variables had values of more than 0.7.

5. Results

The study's target demographic was all Kitale towns' small and medium businesses. In this case, a total of 125 respondents were chosen using a simple random sample procedure, and data were gathered using questionnaires, of which 124 were completely completed and returned, resulting in a response rate of 99.2 percent. 66% of the participants were men, and 34% were women. This demonstrates that, despite a small male dominance, both genders were represented, indicating that the replies were not biased. The findings show that:

- 48 percent of respondents were between the ages of 26 and 35,
- 32 percent were between the ages of 36 and 45,
- 11 percent were between the ages of 18 and 25, and
- The remaining 9% were beyond the age of 46

This indicates that the majority of the respondents (more than 80%) were above the age of 25 and hence capable of giving accurate and trustworthy information about the research.

As demonstrated, 31% had only completed elementary school, 27% had completed secondary school and received a diploma or certificate, 10% had postgraduate degrees, and just 5% had completed undergraduate degrees. This suggests that around half of the respondents (less than 45 percent) had completed secondary school, implying they were not yet fully prepared with the necessary financial management skills.

According to the data, 39 percent were partners, 26 percent were owners, 19 percent were directors, 15 percent were line managers, and just 2% were other employees. This demonstrates that all respondents were critical in maintaining the success of the SMEs' operations and hence supplied reliable information on the financial management strategies used. According to the findings:

- 32% of the companies had been in business for less than 2 years,
- 28% for 2-4 years,
- 21% for 5-8 years,
- 10% for 8-10 years, and
- 10% for more than 10 years

This indicates that the majority of the SMEs (more than 60%) had been in business for a long time and were, thus, familiar with the market dynamics and financial procedures adopted by the companies.

According to the data:

- 36% had less than 5 workers,
- 28% had 6-10 people,
- 15% had 11-20 employees,

- 13% had 21-50 employees, and
- 7% had more than 50 employees

This indicates that the majority of SMEs (more than 55 percent) had less than 10 workers, indicating their tiny size.

The goal of the research was to see how much cash budgeting was used in the performance of SMEs. A five-point Likert scale was employed, with 1 indicating a very tiny extent, 2 indicating a modest extent, 3 indicating a moderate degree, 4 indicating a significant extent, and 5 indicating a very large extent.

Capital Budgeting Practices	VLE	LE	ME	SE	VSE	Mean	SD
Periodical Budget estimations	7	10	22	35	27	3.64	1.185
Creation of financial statements	19	9	18	29	25	3.31	1.439
Financial analysis	4	14	17	41	24	3.68	1.108
Activity-based budgeting	15	21	19	23	22	3.15	1.385
Business Proforma creation	10	23	15	37	15	3.23	1.237
Total						3.40	1.271

Table 1: Capital Budgeting and Performance of Small and Medium Enterprises

The results reveal that financial analysis (mean of 3.68, a standard deviation of 1.108) and periodic budget projections are common in SMEs (mean of 3.64, a standard deviation of 1.185). SMEs prepare financial statements (mean of 3.31, a standard deviation of 1.439), activity-based budgeting (mean of 3.15, a standard deviation of 1.385), and business proforma to a considerable level (mean of 3.23, a standard deviation of 1.237). Overall, with an average mean of 3.40 and a standard deviation of 1.271, Cash Budgeting was found to be moderately implemented among SMEs. This indicates that, despite the advantages of cash planning, it has yet to be properly incorporated into SMEs' performance.

Capital Structure Practices	VLE	LE	ME	SE	VSE	Mean	SD
Maintains proper records for all payables. Maintains inventory records which are updated regularly	21	10	24	30	15	3.09	1.362
Optimal cash balances are maintained by the company at all times	17	21	11	28	23	3.19	1.433
Receivables management system is fully automated	14	15	18	34	19	3.30	1.319
The company has a Capital structure management system	2	2	26	50	20	3.85	0.827

Table 2: Capital Structure Practices and Performance of Small and Medium Enterprises

Table 2 shows that the firms have a capital structure management system to a great degree (mean of 3.85, a standard deviation of 0.827). The company's receivables management systems are entirely automated (mean of 3.30, a standard deviation of 1.319), and it maintains ideal cash balances at all times (mean of 3.19, a standard deviation of 1.433). While SMEs keep adequate records for all payables to a lesser degree (mean of 3.09, a standard deviation of 1.362). This assured that the companies had enough cash on hand to meet their present financial commitments.

Cash Flow Projection	VLE	LE	ME	SE	VSE	Mean	SD
SMEs use short-term loans to bridge the financing gap	0	7	29	40	23	3.80	0.883
Prepares cash flow forecasts to identify future surpluses and deficits	2	27	19	37	15	3.38	1.086
Ensures there is sufficient cash flow to meet daily needs	8	24	16	29	23	3.34	1.287
SMEs use retained earnings to bridge the financing gap	13	15	10	37	26	3.48	1.358
Business is financed by the owner's personal financing	18	17	8	30	27	3.32	1.479
Total						3.46	1.219

Table 3: Cash Flow Projection and Performance of Small and Medium Enterprises

As illustrated, SMEs rely heavily on short-term loans to bridge the funding gap (mean of 3.80, a standard deviation of 0.883). SMEs use retained earnings to a moderate extent (mean of 3.48, a standard deviation of 1.358), prepare cash flow forecasts to identify future surpluses and deficits (mean of 3.38, a standard deviation of 1.086), and ensure there is sufficient cash flow to meet daily needs (mean of 3.34, a standard deviation of 1.287). The firm is funded to a degree by the owner's own funds as well (mean of 3.32, a standard deviation of 1.479). This indicates that cash flow projections were used only modestly in SMEs, with an average mean of 3.46 and a standard deviation of 1.219. As a result, the financing techniques in financial management were not fully exploited.

Financial Performance	VLE	LE	ME	SE	VSE	Mean	SD
Return on capital employed	0	2	42	40	15	3.69	0.758
Return on Assets	7	23	15	36	20	3.40	1.223
Return on Investments	11	23	26	23	18	3.14	1.258
Operating profit margin	19	18	19	20	23	3.11	1.453

Table 4: SMEs' Performance

The results revealed that:

- Return on capital employed had a mean of 3.19 and a standard deviation of 1.318 to a great degree,
- Return on assets had a mean of 3.40, and a standard deviation of 1.223,
- Return on Investment had a mean of 3.14 and a standard deviation of 1.258,
- Operating profit margin had a mean of 3.11 and a standard deviation of 1.453

All of them were quite high. This indicates that SMEs were operating rather well, but there was room for improvement, which better financial management methods might achieve.

		SME Financial Performance	Capital Budgeting	Capital Structure	Cash Flow Projection	Government
Capital Budgeting	Pearson Correlation Sig. (2-tailed)	.372** 0.000	1			
Capital Structure	Pearson Correlation Sig. (2-tailed)	.536** 0.000	.495** 0.000	1		
Cash Flow Projection	Pearson Correlation Sig. (2-tailed)	.716** 0.000	.510** 0.000	.652** 0.000	1	
Government	Pearson Correlation Sig. (2-tailed)	.729** 0.000	.449** 0.000	.620** 0.000	.746** 0.000	1
N		124	124	124	124	124

Table 5: Correlation Analysis

*. Correlation is Significant at the 0.05 Level (2-Tailed)

**Correlation is Significant at the 0.001 Level (2 Tailed)

Capital Budgeting had a Pearson Correlation of 0.372 and a p-value of 0.000, Cash Flow Projection had a Pearson Correlation of 0.716 and a p-value of 0.000, Capital Structure had a Pearson Correlation of 0.536 and Cash Flow Projection had a p-value of 0.000, and Government had a Pearson Correlation of 0.729 and a p-value of 0.000, as shown in table 5. This indicates that all of the factors had a favorable impact on the performance of the SMEs. This indicates that if these factors rise, the organization's profits will rise as well. All of the p-values were less than 0.05, indicating that the impact was significant. This implies they can anticipate changes in operational performance at any point in time.

R	R Square	Adjusted R Square	Std. Error of the Estimate
.722a	0.521	0.509	0.56148

Table 6: Model Summary

Predictors: (Constant), Capital structure, Capital Budgeting, Cash Flow Projection

The goal of the research was to see whether there was a link between financial management methods and financial performance. According to the regression analysis, financial management techniques explained 52.1 percent of the overall variance in the performance of SMEs in Kitale town ($R^2=0.521$). This suggests that additional variables not included in the model account for just 47.9% of the variations in performance.

	Sum of Squares	Df		Mean Square F	Sig.
Regression	41.19	3		13.73 43.55	.000a
Residual	37.832	120		0.315	
Total	79.022	123			

Table 7: Analysis of Variance

Predictors: (Constant), Capital structure, Capital Budgeting, Cash Flow Projection

Dependent Variable: SME Financial Performance

The research went on to use analysis of variance to determine the model's relevance in characterizing the link that exists. The test of variance findings in table 7 suggests that the model is viable for further analysis, with $F(123) = 13.73$, $P.001$. This indicates that the independent factors are a good predictor of performance variances.

	Coefficients B		Standardized Coefficients		
			Std. Error Beta	t	Sig.
(Constant)	0.768	0.263		2.927	0.004
Capital Budgeting	-0.018	0.075	-0.018	-0.241	0.810
Cash Flow Projection	0.123	0.084	0.125	1.453	0.149
Capital structure Management	0.669	0.09	0.644	7.411	0.000

Table 8: Model Coefficient

a. Dependent Variable: SME Financial Performance

The constant value in table 8 indicates that the performance of SMEs will always be at a minimum (0 = 0.768, P = 0.004). Cash Flow Projection (2 = 0.123, P = 0.149) and Capital Structure (3 = 0.669, P = 0.000) were shown to have a favorable effect on SMEs' performance, but Capital Budgeting (1 = -0.018, P = 0.810) had a negative impact. This means that improving finance processes and capital structure will lead to better performance, while capital budgeting will lead to a drop in performance. Except for Capital Budgeting, all of the factors were significant, with p values less than 5% (P 0.05), indicating that they may be able to successfully explain any changes in performance.

6. Conclusions

Capital budgeting, capital structure, and cash flow are the three primary financial management methods that SMEs should implement, according to the report. On the other hand, financial management methods are only modestly adopted in businesses. As a result, the research indicates that although there is an acknowledgement of the value of financial management methods in improving performance, they have yet to be completely incorporated into their operations. This might be due to difficulties encountered in implementing financial management methods, such as budgetary limits, a lack of competence, insufficient policies, and a lack of knowledge of these practices.

The research also discovered that the size of the SMEs had a moderating influence on their performance. As a result, bigger SMEs were better positioned to enhance their performance than smaller ones. As a result, the research suggests that the size of a small business is a major factor in its success. Managers and owners of SMEs should strive to improve their assets and value to compete successfully in today's changing market settings. Milkah (2014), who researched the factors of financial performance of small and medium firms in Kenya, discovered a similar impact brought about by the firm's size.

The researchers discovered that financial management methods had a considerable favorable impact on SMEs' performance. As a result, the research concludes that the present success of SMEs in Kitale County may be largely attributed to the financial management methods that have been implemented. As a result, efficient adoption and exploitation of financial management strategies in SMEs will result in better and enhanced business performance. This is accomplished by having a more structured, transparent, and dependable financial management system in place for both the immediate and long-term responsibilities of SMEs.

7. Recommendations

According to the research, financial management methods have a favorable impact on SMEs' performance. As a result, the research suggests that SMEs' managers and owners prioritize the use of financial management procedures. As a result, they should not only develop financial management plans but also monitor and assess their effectiveness regularly. This will help to enhance the poor levels of practice implementation. The report also suggests that before adopting any financial management approach, SMEs' managers/owners should assess its applicability based on the organization's structure, culture, and rules. This will verify that the financial management processes in place are capable of meeting and exceeding their goals and objectives. The report also advises SMEs' managers and owners to think about the size of their businesses before making any management decisions.

According to the report, the government and other regulatory organizations should adopt favorable rules for applying financial management techniques in SMEs. This will guarantee that financial management methods are used and adopted in SMEs effectively, efficiently, and consistently. In addition, the report suggests that the government and other policymakers give incentives to encourage more SMEs to embrace financial management methods. Additionally, outlets should be created for SMEs to assist one another in improving their financial management skills.

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