





## 2. Literature Review

### 2.1 Theoretical Review

#### 2.1.1 Stochastic Models of Firm Growth

Developed mainly in the field of economics, Stochastic Models of Firm Growth suggests that many factors affect the growth of a firm and that there is no dominant theory. Based on this model, devolution of the governance system is perceived to be one of the factors influencing the growth of SMEs. Stochastic firm growth theories emanate from Gibrat's (1931), whose law of proportionate effect postulates that the proportionate growth rate of a firm is completely randomly determined and hence independent of systematic factors such as previous growth rates. In other words, factors that influence firm growth, such as growth of demand, managerial talent, innovation, organizational structure and legislation are distributed across firms in a manner which cannot be predicted from information about firm's previous growth performance (Goddard *et al.*, 2001). O'Farrell & Hitchens (1988) cite empirical evidence which upholds the view that firms' growth may be dependent on interrelated factors. Stochastic Model may apply in the context of SMEs as it highlights the factors that may influence the growth of a firm which is the subject of this study.

#### 2.1.2 Life Cycle Development Model

The firm life-cycle theory has been widely used to investigate the conceptual domains of business strategy entrepreneurship and firm growth (Lester, Parnell & Carraher, 2003). The firm life-cycle theories have their origins in the field of economics according to which SME growth is viewed as a series of phases of development through which the business may pass as an enterprise life-cycle. This is the most prevalent explanatory device employed by researchers for explaining growth in SMEs. The stages of Lester, et al (2003) model consisted of existence, survival, success, renewal and decline. These stages are very similar to the general scheme of life-cycle stages proposed by other authors, and can be identified with the general pattern of birth, growth, success, decline and death. Unfortunately, over time there have been a great many stage models of growth proposed in the literature, and there is a bewildering range from which to choose for the purposes of research. The number and nature of growth or development stages in these models vary widely from author to author, as do their emphases (O'Farrell & Hitchens, 1988).

#### 2.1.3 Budgetary Recommendations on SMEs Growth

According to Republic of Kenya (2012) the committee should strive to incorporate the views of all stakeholders in the county especially from the business sector regarding the county's budgetary allocations. The county led legislations imply that the participation of citizens including SMEs in the respective counties is mandatory. The county representatives provide an oversight provision of services, deliberate on proposed annual budget estimates and development plans, monitor development activities and receive presentations, including feedback on issues raised by the county citizens. In the context of the growth of SMEs, the work of the committee can enhance the activities of SMEs if the committee creates linkages between the various

county structures and ensures that the structures link up with SMEs subsector through the various county service departments during budget preparation.

Given the new structure of governance, the county led SMEs policies in the proposed SMEs legislation are aligned to the trade, industrial department and regulation service departments. The extent to which the new county system contributes to SMEs development in the respective counties depends on how best the current SMEs Act, 2012 is restructured to factor in the administrative changes as outlined in the current administrative structure. There is thus need for the committee members to ensure that the county assembly develops SMEs policies based on the local needs and such policies should indicate how the institutional and regulatory framework links up with the governance structure at the county level under the current constitution to promote the growth of SMEs (Chepkemoi, 2013).

#### 2.1.4 Growth of SMEs

The current constitution provides for the establishment of counties and by extension, County led business institutions and regulations. Within the county government there are the finance and investment committees that are charged with overseeing the county's development agenda. According to Kiveu and Ofafa (2013) the county governments finance and investment committees have a role to play in promoting the development of each county. This implies that the county's FIC is instrumental in resource allocation and planning for the development of SMEs in each county. This is because the overall role of FIC is planning the development of the county. According to the County Governments Act (2012), the duties of this committee include preparation of the county budget, review of requests for bond issues, and appropriations of county monies prior to any action by the full Board. The committee studies and recommends taxes and other means of financing the county's programs and handles the sale of delinquent property. The committee is composed of seven (7) members. According to Chepkemoi (2013) the committee is capable of effectively discharging its mandate if its members are conversant with international, national and local business environment. This is because FIC usually reviews the County's investment portfolio and makes recommendations on any changes in investments to the relevant organs. The committee is also responsible for establishing basic standards of risk to direct the operations of entrepreneurial activities in the county as well as making recommendations on each county's depository.

Several scholars have studied the influence of diverse factors into the growth of SMEs in Kenya. Chepkemoi (2013) summarizes the challenges facing SME at the county level include overlap and inconsistencies in legal and sectoral policies; lack of clear boundaries in the institutional mandates; lack of a suitable legal framework, outdated policies, exclusion in policy development; lack of access to credit; lack of a central coordination mechanism and lack of a devolved coordination. In Nakuru town, a number of SMEs growth indicators have been observed including the number of business enterprises, number of business activities, increase in market for the production, increase in employment absorption rate, overall economic growth and increased rate of investment in real estate by SMEs

entrepreneurs. Preliminary studies show that the new constitutional dispensation and the institutional framework proposed under the new SME Act and the mandate given to the finance and investment committee are important developments that can help the evolution and success of SMEs. There is a wide range of programmes in diverse areas of SME development, where the committee can make recommendations such as financing, technology, innovation, managerial ability, market information, and developmental assistance, aimed at improving the working environment for SMEs. Thus, what might be considered as a great contribution to the growth of SMEs is the role of finance and investment committee.

According to a report by the Republic of Kenya (2012) several initiative recommendations should be undertaken by the committee to enhance the growth of business opportunities at the county level. These include county consultative meetings, explicit and open policy development processes and transparent county government activities. Supportive county government institutions evidenced by an operational public-private dialogue framework would provide avenues through which the SMEs associations can present their interest at the county level through the county assemblies.

According to Iorpev (2012) these initiatives are tasked with ensuring that SMEs produce quality products that meet both local and international standards, while enhancing consistency and cooperation with other sectors. Recent studies show that some county governments have started upgrading the SME products, building capacity to manufacture upgraded products, promoting innovation and technology transfer, instilling a culture of quality and standardization and promoting the use of intellectual property as a tool of trade and business. A study by Kiraka, Kobia & Katwalo (2013) found out that these initiatives have recorded encouraging results in some counties including training over 1,000 SMEs on mass production of quality products while diversifying on their portfolios. The result has seen the growth of many SMEs especially those in the manufacturing and telecommunication sectors.

### 3. Research Methodology

#### 3.1 Research Design

The study used a descriptive research design because such a design allowed simultaneous description of views, perceptions and beliefs of the respondents at any single point in time. This technique was appropriate for obtaining factual and attitudinal information for research questions about self report, beliefs, opinions and characteristics of the respondents' behaviours. The target population for this study was about 5000 legally registered SMEs in Nakuru Town and members of the finance and investment committee of the County Government of Nakuru. Purposive sampling technique was used to select the 7 members of the finance and investment committee in the county government of Nakuru. Stratified sampling method was used to obtain a sample size of 80 respondents from SMEs in Nakuru Town. This constituted a total of 87 respondents. The researcher used the questionnaire and the interview schedule to collect

data. The data was coded to enable the responses be grouped into various categories. A descriptive analysis was employed. Descriptive statistics was used to summarize the data. This included percentages and frequencies. Tables were also used to present the data collected for ease of understanding and analysis. Regression analysis was used to establish the association between the independent and dependent variables.

### 4. Results and Discussion

#### 4.1 Budgetary Recommendations on the Growth of SMEs

The study examined the effects of budgetary recommendations of the finance and investment committee on the SMEs growth in Nakuru Town. This was done by asking the respondents to indicate their level of agreement or disagreement with different statements relating to budgetary recommendations. Table 1 presents results obtained from the study.

**Table 1:** Budgetary Recommendations of FIC and SMEs Growth

Statements	SD	D	N	A	SA	N	Mean	SDev
SMEs are satisfied with the budgetary recommendations of investment and finance committee in the county	7	13	10	14	36	80	3.74	0.67
budgetary recommendations made by the finance and investment committee benefit your SME	8	11	9	14	38	80	3.79	0.87
SMEs views are incorporated in the county's budgetary allocations.	9	10	9	20	32	80	3.70	0.63
Participation of SMEs operators is mandatory in budget making	11	7	20	7	35	80	3.73	0.59
There is provision of feedback on issues raised by the county SMEs	17	10	10	16	27	80	3.34	0.45
The work of the committee enhances the activities of SMEs by creating linkages with various county structures	10	17	10	16	27	80	3.41	0.47

The study sought to establish the extent to which selected attributes of the budgetary recommendations of the finance and investment committee affected growth of SMEs in Nakuru Town. From the findings, higher response rate was reported in regard to budgetary recommendations made by the finance and investment committee benefiting SMEs, SMEs were satisfied with the budgetary recommendations of the investment and finance committee, participation of SMEs operators being mandatory in budget making, SMEs views being incorporated in the county's budgetary allocations in Nakuru Town suggesting a significant effect on SMEs growth with a mean effect of 3.79, 3.74, 3.73 and 3.70 and standard deviation of 0.87, 0.67, 0.59 and 0.63 respectively. These findings are supported by a recent survey on 117 SMEs in which 111 SMEs reported that their growth

had increased due to favourable county government budgets (Kaplan & Schultz, 2006). Of these, 32% increased their sales volume by more than 50%. The results also show relatively higher response rate in regard to the effect of the recommendations of the FIC as enhancing the activities of SMEs by creating linkages with various county structures and there being a provision of feedback on issues raised by the county SMEs in Nakuru Town as indicated by a mean of 3.41 and 3.34 with a standard deviation of 0.47 and 0.45 respectively. The findings agree with that of Chen (2005) who investigated the relationship between favourable legislation on financial growth of SMEs and found out that more than 60% of internal growth in SMEs was linked to favourable business environment.

Qualitative data from the interview with the finance and investment committee members showed that the finance and investment committee made budgetary recommendations that enhanced the growth of SMEs in the county. This is in agreement with the ROK (2012) which states that the finance and investment committee can recommend the incorporation of the views of all stakeholders in the county especially from the business sector. The qualitative data also shows that the finance and investment committee provides an oversight provision of services, deliberate on proposed annual budget estimates, develop plans, monitor development activities and receive presentations, including feedback on issues raised by the county citizens. This is similar to the observation by Chepkemoi (2013) that the committee members' role is to ensure that the county assembly develops SMEs policies based on the local needs and such policies should indicate how policy framework links up with the governance structure at the county level under the current constitution to promote the growth of SMEs.

#### 4.2 Growth of SMEs in Nakuru Town

The study examined the extent of growth of SMEs in Nakuru Town. This was done by analyzing various indicators of SMEs growth. The findings obtained are presented in the subsequent sections.

#### 4.3 Classification of SMEs Growth According to the Number of Employees

The study sought to establish the number of employees in the various SMEs investigated. The findings obtained are presented in Table 2.

**Table 2:** Classification of the SMEs According to the Number of Employees

Number of Employees	Frequency	Percentage
Less than 10 Employees	24	30
Between 10 to 20 Employees	15	19
Between 21 to 30 Employees	25	31
Between 31-40 Employees	8	10
Between 41-50 Employees	5	6
Above 50 Employees	3	4
<b>Total</b>	<b>80</b>	<b>100</b>

As shown in Table 2, 31 % of the SMEs had between 21-30 employees while 30% had less than 10 employees. It is also

shown that SMEs with between 10 and 20 employees were 19% compared to 10% of the SMEs with between 31-40 employees. The SMEs with between 41-50 employees were 6% as compared to 4% of the SMEs with over 50 employees.

#### 4.4 Description of SME Growth Strategy

The study also sought to determine the growth strategy employed by the SMEs. The results obtained are presented in Table 3.

**Table 3:** SMEs Growth Strategy

Growth Strategy	Frequency	Percentage
Increasing the revenue	35	44
To expand the business	30	38
To hire more employees	15	18
<b>Total</b>	<b>80</b>	<b>100</b>

The findings presented in Table 3 reveals that majority (44%) of the respondents' emphasized increasing revenue as their growth strategy while 38% focused on business expansion. Slightly less than 20% emphasized hiring of employees.

#### 4.5 Measuring SME growth in Nakuru Town

The study sought to establish how growth was measured among SMEs in Nakuru town and the results obtained are presented in Table 4.

**Table 4:** How Growth is measured by SMEs in Nakuru Town

Measuring SME growth	Frequency	Percentage
By using income	27	34
By using sales	27	34
By using business partners	4	5
By using how regional the company is	7	9
By using the number of employees	15	18
<b>Total</b>	<b>80</b>	<b>100</b>

As revealed in Table 4, majority of SMEs in Nakuru town measure business growth by the use of both income and sales as pointed out by 34% of the respondents respectively. Similarly 18% of the SMEs measure growth by the use of the number of employees while 5% and 9% of the SMEs measure growth by the use of business partners and regional presence of the business respectively.

#### 4.6 Indicators of SME Growth

This section presents results on the indicators of growth as obtained from the study findings.

**Table 5:** Responses on the Indicators of SMEs Growth

Measuring SME growth	Frequency	Percentage
Sales Volume	16	20
Assets	12	15
Employment Growth	10	13
Market Share	12	15
Profits	20	25
Investment from Returns	10	13
<b>Total</b>	<b>80</b>	<b>100</b>

The analysis of results in Table 5 shows that ways of measuring growth were as follows: sales volume 16(20%), Assets 12(15%), Employment growth 10(13%), Market share 12(15%), profits 20(25%), investment on returns 10(13%). From the above description, it can be revealed that profit was the major indicator of growth of the SMEs in Nakuru town.

4.7 Regression Analysis

Table 6: Regression Model Summary

Model	R	R <sup>2</sup>	Adjusted R <sup>2</sup>	Std. Error of the Estimate	Change Statistics				
					R <sup>2</sup> Change	F Change	df <sup>1</sup>	df <sup>2</sup>	Sig. F Change
1	.887 <sup>a</sup>	.787	.619	1.2467	.787	65.76	1	79	.000

The results in Table 6 show that there is a positive relationship between the role of finance and investment committee and the growth of SMEs (R= 0.887). The adjusted R squared in the model in Table 6 is the coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variables. As shown the value of adjusted R was 0.619 indicating that there was variation of 61.9% of growth of SMEs in Nakuru Town due to changes in budgetary recommendations at 95% confidence interval. This shows that 61.9% changes in growth of SMEs could be accounted for by budgetary recommendations of the finance and investment committee of Nakuru county government. As presented in the model, R is the correlation coefficient which shows the relationship between the study variables. Therefore from the findings shown in the Table 6 there was a strong positive relationship between the study variables as shown by R= 0.887.

Table 7: Coefficients

Model 1	Unstandardized Coefficients		Standardized Coefficients	F	Sig.	
	B	Std. Error	Beta			
1	Constant	.417	.341	.559	1.638	.003
	Budgetary Recommendations	.439	.365	.305	1.673	.004

From the data in Table 7 the established regression equation was:  $Y = 0.417 + 0.439X_1$

From the above regression equation it was revealed that holding budgetary recommendations to a constant, growth of SMEs would be 0.417. It also shows that a unit increase in budgetary recommendations would lead to increase in growth of SMEs in Nakuru Town by a factor of 0.439. The significance of the variables was supported by the F values whose significance values were less than 0.05 which indicates that the variables were statistically significant in influencing growth of SMEs in Nakuru Town.

5. Conclusion and Recommendations

From the findings, the study found that budgetary recommendations affected the growth of SMEs in Nakuru town. The study revealed that a unit increase in budgetary recommendations led to an increase in growth of SMEs. This relationship indicates that budgetary recommendations

This section presents the findings on the relationship between the role of finance and investment committee and growth of SMEs in Nakuru Town. The indicator of finance and investment committee was budgetary recommendations while the indicators of growth of SMEs were sales volume assets, employment growth, market share, profits and investment on returns. The relationship was established through regression analysis whose summary is presented in Table 6.

significantly influenced the growth of SMEs in Nakuru Town. The study concludes that there was a strong relationship between the growth of SMEs and budgetary recommendations of the finance and investment committee of the county government of Nakuru. Based on the findings, the study recommends a need for the finance and investment committee to enhance its budgetary recommendations to the county government of Nakuru so as to improve the growth of SMEs in Nakuru Town.

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