Effects of Bookkeeping on Growth of Small and Medium Business Enterprises in Kabarnet Town, Baringo County, Kenya

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Abstract: This study sought to investigate the effects of bookkeeping on the growth of small and medium business enterprises in Kabarnet Town. The study objective was to find out how books are kept in SMEs, analyze the growth of small and medium enterprises and to establish the relationship between bookkeeping and growth of SMEs in Kabarnet Town. The study was based on a descriptive survey design and targeted all SMEs operators in Kabarnet town. A sample of 72 respondents was selected through stratified random sampling techniques. The data was analyzed using descriptive statistics and analyzed using percentages. The results were presented using tables and figures. The study findings show that many SME operators in Kabarnet town maintain sales record books using the double entry system. The study also shows that book keeping positively enhancing SMEs growth as measured by profitability and the findings of this study could provide useful information that will help the business community in Kabarnet town to appreciate the role of bookkeeping in their businesses.

Keywords: Bookkeeping, Double Entry, SMEs, SMEs Growth, Kabarnet Town, Baringo County, Kenya

1. Introduction

Since the prospects of getting white collar jobs has become harder and harder, many people, educated and non-educated, are reverting to being self-employed. One way of being self-employed is to start a small business. A small business is any business that is independently owned and operated (Kuehl, 2006). Generally, Small and medium enterprises (SMEs) are businesses whose turnovers fall below certain limits. The current definitions categorize businesses with less than 10 employees as “micro,” those with fewer that 50 employees as “small” and those with less than 250 as medium”. SMEs therefore need to have between 20-500 employees (Williams, 2010). The definition of an SME may also depend on the number of employees, business turn over and assets (Aremu & Adeyemi, 2011).

SMEs play a big role in the economy as they provide employment and taxes in all sectors of the economy including agriculture and mining. Small and medium enterprises make up the backbone of the world economy (Aremu & Adeyemi, 2011). For example, they account for 67.1% of the European Union non-financial business economy workforce. Hence, in many countries in the world it has been recognized that an SME-friendly business environment is crucial for growth and jobs creation (Kuehl, 2006). In some key industries, such as textiles, wood products, metal products, publishing, construction and furniture-making, SMEs account for more than 70% of all jobs. Small business enterprises are therefore a part of the informal sector and they bridge the gap of slow growth of the informal sector in the economy.

In Kenya, SMEs play a major role in the economy. They contribute to the economy in terms of output of goods and services, creating demand and supply for their products, contribute to increased participation of indigenous Kenyans in the economic activities, strengthen forward and backward linkages among socially, economically and geographically diverse sectors of the economy and offer opportunities for entrepreneurial and managerial talents (Republic of Kenya, 2012). Although SMEs play a big role in the development of the economy, most researchers point out that they have not been performing well. Recent studies indicate that the most probable cause is lack of or limited book keeping (Chepkemoi, 2013).

Bookkeeping is the recording off all financial transaction in a systematic and logical manner. Transactions include sales, purchase income, and payments by an individual or organization. Book keeping is usually performed by a book keeper using common methods of bookkeeping such as single entry and double entry systems. While these systems may be seen as “real” book keeping, any process that involves recording of financial transactions is a bookkeeping process (Haber, 2004). Primary bookkeeping records all business transactions and allocates the income and expenses to various income and expenses account in separate account records (McCarthy, 2000). The single book keeping can be done with book keeping software to speed up manual calculation (Haber, 2004). Double entry book keeping system involves recording of financial information in a financial accounting system where a financial transaction impacts at least two different accounts. In modern accounting, this is done using debits and credits and serves a kind of error system. If at any point the system of debits doesn’t equal to the sum of credits then an error has occurred. In SMEs, bookkeeping vary in size, frequency, sensitivity, maturity and the level of growth of the SMEs including the relative importance of fixed working capital. The system of book keeping depends on the operator of the SMEs (Enon, 2000).
SMEs are required to keep proper records of financial data concerning all receipts and payments, all sales and purchases of goods and services and all assets and liabilities from which financial statements are prepared. The financial transaction recorded must be objective, sufficient, relevant and reliable to make informed decisions and judgments by interest groups. Despite the importance of book keeping a number of SMEs in Kabarnet Town have not given much attention.

1.2 Statement of the Problem

The necessity of recording all the transactions clearly and systematically cannot be over-emphasized. Accounting records, prepared on the basis of uniform practices enable business to compare results of one period with another period. Taxation authority (both income tax and VAT) are also likely to believe the facts contained in the set of accounting records/books if they are maintained according to generally accepted accounting principles. Accounting records backed up by proper authenticated vouchers are good evidence in court of law in the event of fraud by the customers, suppliers and employees. Studies on SMEs have disclosed that about 60% of small businesses fail within the first three years due to management inefficiencies brought about by poor record keeping. Further studies indicate that a significant element in the failure of many businesses is due to inefficient or absence of book keeping. An adequate financial record-keeping-system will provide the required information to assist SMEs to make sound decisions for future plans. However, many SMEs do not maintain accounting records yet they perceive the positive role of accounting records in the business performance. Although accounting records have been cited as one of the possible factors contributing to success of business, there is no research done to establish how accounting influences performance. Little information if any is available on the role of book keeping on performance of SMEs. Hence, it’s against this background that the study investigated the effects of bookkeeping on the growth of SMEs in Kabarnet town.

1.3 Objectives of the Study

i. To determine the types of book keeping among the small and medium enterprises in Kabarnet town.
ii. To establish whether SMEs in Kabarnet Town use book keeping as accounting tool to ascertain the financial position of their businesses.

2. Literature Review

2.1 Theoretical Review

This section presents three theories advanced by scholars that were considered relevant to understanding the effects of bookkeeping on the growth of SMEs. These theories are the information theory, the decision making theory and the measurement theory.

2.1.1 Information Theory

The fundamental function of accounting and book keeping is communication. Accounting statements are used to inform managers, owners of businesses and external users of the financial aspect of the business entities. They are the main formal bases for finance decisions since accounting systems basically information system (Freeman, 2008). According to Holmes and Nicholls (1988) data becomes accounting information only when it is measured and is bounded by the criteria of relevance, verifiability, freedom from bias and quantifiability. The terms, relevance, verifiability, freedom from bias and quantifiability may be regarded as the attributes that provide internal boundary of accounting information. Under this theory, information is regarded as a resource, the collection, processing and transmission of which involve a cost. Such costs accelerate with the increase in the volume of information. It is, therefore, important to associate the process of information generation with the costs associated with it. Only this criterion can help to consider the optimal level of information supply by measuring cost of information supply in relation to its benefits to the users.

2.1.2 Decision Theory

The essence of this theory is that decision-making is not an intuitive process but a conscious evaluation of the possible alternatives that leads to best result or optimizes the desired goal (Freeman, 2008). Decision theory on accounting was pioneered by Herber Simon in 1952. Decision theory is concerned with identification of the best alternatives that leads to best result or optimizes the desired goal (Freeman, 2008). Decision theory on accounting can not be viewed as a discipline with practically no interaction with other operating functions of the business (Freeman, 2008). In fact, accounting functions are intertwined with managerial analysis because, as an information system it provides significant meaningful information about the firm both for internal management use and external financial reporting (Freeman, 2008).

2.1.3 Measurement Theory

Measurement means assigning of numerals to objects or events according to some rules. The process of preparing financial statements is considered to be a process of measurement. In bookkeeping the first step is to select the object and their attributes (Holmes & Nicholls, 1988). Accordingly, accounting has been defined as a measurement discipline that pertains to the quantitative description and projection of income circulation and of wealth aggregates in explicit monetary terms. Thus, although the term measurement has been typically defined as the assignment of numerals to objects or events according to rules, in relation to accounting, measurement implies financial attributes of economic events that are called accounting valuations which simply means assigning numbers to the assets and liabilities and ranking them on the priority like from less liquid assets to highly liquid assets (Haber, 2004).

2.2 Empirical Review

The book keeping transactions of an enterprise need to be recorded in the book keeping books. Some form of recording was essential to all businesses for the day-to-day
management of their operations and the fulfillment of unavoidable governmental obligations such as taxation. It is well known that inadequate record keeping is frequently associated with failures in small businesses even if it is not actually the direct cause of failure. For record keeping purposes the enterprise can use different methods.

2.2.1 Types of Bookkeeping and the Growth of SMEs
Book keeping records are e.g. the sales day book, purchases day book, cash receipt book, cheque payments book, petty cash book, general journal, nominal ledger, debtors’ ledger and creditors’ ledger. Quite often a separate payroll system is maintained and payroll transactions are summarized through general journals. However, all enterprises do not necessarily need the entire above mentioned book keeping records; the enterprise has to decide this on the basis of its needs. When the enterprise makes the judgment of what book keeping records to maintain it also needs to take into account whether some book keeping records are compulsory in the particular Member State.

2.2.1.1 Single Entry System
The single entry system is an "informal" bookkeeping system where a user of this system makes only one entry of a business transaction. It generally includes a daily summary of cash receipts and a monthly record of receipts and disbursements (worksheets). A cheque book, for example, is a single entry bookkeeping system where one entry is made for each deposit or cheque written. Receipts are entered as a deposit and a source of revenue. Cheques and withdrawals are entered as expenses. If a manual system is used, in order to determine your revenues and expenses you have to prepare worksheets to summarize your income and categorize and summarize your different types of expenses (Cromie, 1991). Bookkeeping software and spreadsheets are also available to do this for you.

The emphasis of this system is placed on determining the profit or loss of a business (Chepkemoi, 2013). It got its name because you record each transaction only once as either revenue (deposit) or as an expense (check). Since each entry is recorded only once, debits and credits (recording method required for the double entry system) are not used to record a book keeping event. While the single entry system may be acceptable for tax purposes, it does not provide a business with the entire book keeping information needed to adequately report the book keeping affairs of a business. In the near future, there will probably be no single entry system (Cromie, 1991).

2.2.1.2 Double Entry System
The double entry system is the standard system used by businesses and other organizations to record book keeping transactions. Since all business transactions consist of an exchange of one thing for another, double entry bookkeeping using debits and credits, is used to show this two-fold effect. Debits and credits are the device that provides the ability to record the entries twice. The double entry system also has built-in checks and balances. Due to the use of debits and credits, the double-entry system is self-balancing. The total of the debit values recorded must equal the total of the credit values recorded (Cohen, 2005). This system, when used along with the accrual method of book keeping, is a complete book keeping system and focuses on the income statement and balance sheet. This system has worldwide support as the system to use by businesses for recording their book keeping transactions. It got its name because each transaction is recorded in at least two places using debits and credits (Cohen, 2005).

2.2.2 Bookkeeping and Performance of Small Medium Enterprises
Every serious entrepreneur must as a matter of fact be able to maintain proper records of his or her business transactions. Proper book keeping is important to sustaining and expanding a business (Kenya National Bureau of Statistics, 2007). Without it, the entrepreneur run the risk of hitting cash flow crunches, wasting money, and missing out on opportunities to expand his business. When you keep proper records of your business transactions, you will be properly positioned to carry out proper business evaluation and see how your business is faring. The purpose of book keeping is to help you manage the business and also to enable tax agencies to evaluate the business activity. As long as book keeping achieves both of these objectives, the business will be in the right direction. Any financial institution that wants to do business with the firm must demand for the business records. The ability to produce it means that the business is serious. Business records are important because it prevents theft and keeps things organized. The practice of keeping accurate records of the business inventory makes it easier to record products and also to enable the business owner to see what’s selling and those that are not selling. It is important to keep business records because without them you would not know how to break even, or even how much each different product is really making you (Chepkemoi, 2013). Effective and efficient record keeping practices secure your business internal thief and dishonest employees. Additionally, tracking the transfer of money is important so that the wise business owner can know who received money, how much they currently have or if there are any inconsistencies that need to be investigated or corrected. Keeping accurate records is highly fundamental for a successful business to stay organized and profitable.

Peacock (2008) in his investigation of the effects and causes of 1,000 proprietary company failures in South Australia, found that 4.6 percent of failures had inadequate or no accounting records. He concluded that there was a minimal effect of accounting records of the success or failure of businesses of the proprietary companies and recommended for further research on causes of business failures. In another study of company failures in South Australia, peacock (2008) reviewed the bankruptcy reports of 418 unincorporated businesses for four years and found that 50.5 percent of this used single entry system of bookkeeping, 32.8 percent used bank and taxation records whereas only 2.1 percent utilized double entry systems. He recommended further research to be done on double entry systems of recording in companies. In a more recent study Peacock (2008) found out that a significant element in the failure of many of the businesses was inefficient or absence of accounting records. More than half of the failed businesses were found to have no records or only bank and taxation records. Peacock’s (2008) findings are very important as
examining the impact of bookkeeping system practices on profitability of SMEs in Kabarnet Town. Williams et al (2008) in their evaluation of the adequacy of accounting records for 10,570 small enterprises operating in Australia found that a significant proportion of owners kept inadequate accounting records.

The study recommended further investigation on record keeping practices in small enterprises in Australia. Williams (2010), in his survey of accounting information requirements of 928 small enterprises operating in Sydney, Melbourne and Brisbane found out that 57% of the respondents used the double entry systems. This finding is in contrast to Peacock’s (2008) findings of types of records maintained by failed enterprises, where only 2.1% of respondents were found to use double entry systems. He recommended for further research on the effects of book keeping on the growth of SMEs.

3. Methodology

The study was based on a descriptive survey design. In this design, self administered questionnaires were used to collect data. This design was considered appropriate because it enabled the researcher to collect factual information from the respondents in order to establish the role of bookkeeping on the growth of SMEs. The study was carried out in Kabarnet Town, Baringo County, Kenya. The study site was chosen because the researcher had observed that most businesses were not doing well or closing down possibly due to their failure to keep proper business records. The target population for the study included all the operators of SMEs in Kabarnet town. Through stratified and simple random sampling 100 registered SMEs operators were selected. Data was collected with the help of open ended and closed questionnaires. To ensure validity of the instrument, the development of the research instrument was done carefully by examining the objectives of the study and consulting the supervisor to help in improving the quality of the questions. Reliability is the degree to which an instrument yields consistent results or data after repeated trials. Before the questionnaire was used in the actual study, the researcher used 10 questionnaires to pilot the instrument in Eldoret town. This helped to eliminate any ambiguous items, establish if there would be any problem, test the data type to be collected and establish the feasibility of the research instrument. Data was analyzed using frequencies, percentage and tables.

4. Results

4.1 Types of book keeping among SMEs in Kabarnet Town

Different aspects of book keeping were investigated in response to the first objective of the study. First the study sought to establish whether SMEs operators in Kabarnet town were keeping books of accounts. The results obtained are presented in Table 1.

Table 1: Maintenance of Records by SMEs

<table>
<thead>
<tr>
<th>Response</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>52</td>
<td>75</td>
</tr>
<tr>
<td>No</td>
<td>18</td>
<td>25</td>
</tr>
<tr>
<td>Total</td>
<td>70</td>
<td>100</td>
</tr>
</tbody>
</table>

The findings show that 75% of the SMEs operators in Kabarnet town maintained books of account as compared to 25% who indicated that they did not keep business records. Although most SMEs operators maintained business records, most of them reported that their records were not up to the standard and in line with any specified bookkeeping procedures. As a follow up, the researcher sought to find out the types of books kept by SMEs operators in Kabarnet Town and the findings are presented in Table 2.

Table 2: Kinds of Records Maintained by SMEs

<table>
<thead>
<tr>
<th>Types of Book/Accounts</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchases</td>
<td>17</td>
<td>24</td>
</tr>
<tr>
<td>Sales</td>
<td>42</td>
<td>60</td>
</tr>
<tr>
<td>Do not Know</td>
<td>11</td>
<td>16</td>
</tr>
<tr>
<td>Total</td>
<td>70</td>
<td>100</td>
</tr>
</tbody>
</table>

As shown in table 2, 60% of the respondents maintained sales records compared to 24% of the respondents who reported that they kept purchases records. Those who did not know whether they kept purchases or sales records were 16%. The study further sought to find out the systems of book keeping maintained by SMEs in Kabarnet Town. The results are shown in Table 3.

Table 3: Types of Book Keeping System

<table>
<thead>
<tr>
<th>Type of Book Keeping</th>
<th>Frequency</th>
<th>Percentages (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Double Entry</td>
<td>30</td>
<td>40</td>
</tr>
<tr>
<td>Single Entry</td>
<td>40</td>
<td>60</td>
</tr>
<tr>
<td>Total</td>
<td>70</td>
<td>100</td>
</tr>
</tbody>
</table>

It is evident that 40% of the respondents maintained double entry system of book keeping compared to 60% who reported that they maintained single entry system. This shows that fewer SMEs are appreciating the importance of double entry system of book keeping.

4.2 Book Keeping and Growth of SMEs

The second objective sought to find out whether book keeping in Kabarnet Town influenced growth of SMEs. When asked to indicate how often book keeping helped SMEs operators in Kabarnet Town in assessing their profits, 15% Often, 30% Sometimes, 20% Rarely and 10% Never as shown in figure 1.
The respondents' opinion on whether they used bookkeeping to identify financial position of their business and whether book keeping improves growth of SMEs was sought. The findings are presented in the Table 5.

Table 1: Bookkeeping and Financial Position and Growth of SMEs

<table>
<thead>
<tr>
<th>Statement</th>
<th>YES (%)</th>
<th>NO (%)</th>
<th>Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does Book keeping help to ascertain Financial Position of the Business?</td>
<td>52(75)</td>
<td>18(25)</td>
<td>70(100)</td>
</tr>
<tr>
<td>Does Book keeping improve growth of SMEs?</td>
<td>6(09)</td>
<td>64(81)</td>
<td>70(100)</td>
</tr>
</tbody>
</table>

A critical examination of the responses was done and the summarized findings showed that 75% of the respondents believed that book keeping helped to ascertain the financial position of SMEs compared to 25% who disagreed. In regard to whether book keeping improves growth of SMEs, the results obtained indicate that only 9% of the respondents agreed compared to 81% of who disagreed. This implies that SMEs could use book keeping ascertaining the financial position of the businesses suggesting that there was a positive relationship between book keeping and growth of SMEs. The study also sought to find out whether book keeping contributed to the profitability of the business venture. The findings are presented in Table 6.

Table 6: Book Keeping and the Profitability of SMEs

<table>
<thead>
<tr>
<th>Response</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Always</td>
<td>19</td>
<td>27</td>
</tr>
<tr>
<td>Somehow</td>
<td>27</td>
<td>39</td>
</tr>
<tr>
<td>Never</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>Do not know</td>
<td>15</td>
<td>21</td>
</tr>
<tr>
<td>Total</td>
<td>70</td>
<td>100</td>
</tr>
</tbody>
</table>

The results shows that 27% of the respondents indicated that book keeping always increased the profitability of SMEs, 39% cited somehow, 12% selected Never and 21% did not know. This shows that book keeping practice could be challenge among SMEs in Kabarnet Town based on the fact that only 27% selected always. Responses on whether book keeping contributed to the expansion of branches SMEs in Kabarnet Town are presented in table 7.

Table 7: Book Keeping and Expansion of SMEs

<table>
<thead>
<tr>
<th>Responses</th>
<th>No. of Respondents</th>
<th>Percentages (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>9</td>
<td>13</td>
</tr>
<tr>
<td>No</td>
<td>61</td>
<td>87</td>
</tr>
<tr>
<td>Total</td>
<td>70</td>
<td>100</td>
</tr>
</tbody>
</table>

It is observed in Table 7, that 13% of the total respondents agreed that book keeping lead to the expansion of business branches, while 87% did not believe that it could lead to the expansion of business branches. Majority of the respondents therefore did not believe in using book keeping to enhance business expansion.

5. Conclusions and Recommendations

5.1 Conclusion

The main purpose of the study was to find out the role of book keeping on the growth of SMEs in Kabarnet Town. The study has established that bookkeeping is available among the SMEs in Kabarnet Town with majority of the traders employing single entry bookkeeping system. The type of records maintained by many SMEs traders are the sales records. The study has also established that there is a direct relationship between book keeping, growth and profitability of SMEs. If properly maintained, bookkeeping could lead to increased profitability and expansions of SMEs in Kabarnet Town.

5.2 Recommendations

Based on the conclusions drawn from the study, there is need for the SMEs operators in Kabarnet Town to embrace proper book keeping practices in order to be successful in the financial performance of their businesses. Documents of original entry such as invoices should be properly kept as they are important elements of financial system. It is recommended that SMEs operators in Kabarnet Town should employ sales clerk, who have knowledge in book keeping as a way of helping them to cultivate the habit of preparing trading, profit and loss account. The local chamber of commerce in Kabarnet Town should organize seminars that will teach entrepreneurs on how to keep proper written records. Symposiums, conferences, and open forums can also be used.
References


