An exploratory study of critical success factors for SMEs in Kenya

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Abstract

Purpose: 70% of Small-to-Medium sized enterprises (SMEs) in Kenya fail within their first three years of existence. This paper reports the findings of a study of Kenya SMEs aimed at identifying critical success factors and barriers to their success.

*Methodology:*A comprehensive literature review identified variables previously identified from international research and a questionnaire was designed to survey a sample of Kenya SME owner / senior managers, selected from the Kenya Institute of Management (KIM) SME membership database, to determine their views on which factors were critical to their success.

Findings: Respondents identified maintaining good relationships with customers, having a good product or service, having good marketing skills and creating a brand customers can associate with as the critical success factors. The main barriers to success were identified as high taxes, too much government regulation and corruption in municipal government.

Practical implications: From an owner/ manager perspective there is a need for them to have good marketing skills and to use them to market their goods and services. Customer relationship management (CRM) is also important for repeat purchases. Government has also an important part to play in tackling corruption and ensuring that policies and regulations are in place to create a business climate favourable to SMEs success.

Originality/value: There are many research papers that examine the impact of one or several variables that impact the success or otherwise of SMEs. However, this is one of the few surveys that has examined so many variables simultaneously and within a Kenya context.

Keywords
SMEs; survival; sustainability; Kenya; success factors.

1. Introduction

Small to Medium Size Enterprises (SMEs) make a massive contribution to the economies of most countries world-wide. They are important for job creation, growth and social stability (Chu *et al.*, 2007). Mutandwa *et al.* (2015) describe SMEs in developing countries as "engines of economic growth". It is developing countries in Africa generally and Kenya particularly that are the focus of this paper.

The numbers of micro size enterprises (MSEs) and SMEs change constantly, with many new firms being started every year but also many failing and going out of business – called enterprise churn. Success as measured by longevity is a problem. For example in the UK 50% of business start-ups fail within 5 years. It is essential for developing countries that MSEs and SMEs grow and are successful. Fostering an environment that is favourable to SME development is a major priority for many countries (Akinboade, 2015). The aims of this paper are therefore:

(a) To define MSEs and SMEs within an African context;
(b) To define "success" for SMEs;
(c) To determine how SMEs measure their performance;
(d) To identify critical success factors for SMEs in Kenya, as perceived by their owners or managers;
(e) To identify barriers to SME success as perceived by their owners or managers.

2. Defining SMEs and MSEs

The definition and classification of small businesses tends to vary from country to country based on those countries guidelines for categorization. However it is usually based on the number of employees and annual turnover and value of assets. The most cited definition is that provided by the European Union and which covers its 28 member states. This is based on the number of employees and either annual turnover or Balance sheet total. The categories are shown in table 1 below

Table 1: European Commission Definitions of SMEs

Enterprise Category	Number of employees	Annual Turnover	Balance Sheet Total
Micro	< 10	≤ €50 m	≤€ 43 m
Small	10 - 49	≤ €10 m	≤€ 10 m
Medium	50 - 249	≤ € 2 m	≤€ 2 m

Source: European Commission Eurostat

However, in Africa, countries use different definitions to categorise enterprises. In Ghana, small scale enterprises are those employing between 5 and 50 employees and having an annual turnover of between $$ US 6,000 and $ US 30,000 and with assets of less than $ US 30,000. A medium size enterprise employs between 50 and 100 people (Asamoah, 2014). In Kenya, the focus of this study, micro and small enterprises (MSEs) employ less than 50 people and have an annual turnover between Ksh 500,000 and Ksh 5 million. A medium size enterprise employs between 50 and 100 employees (Kenya Institute for Public Policy Research and Analysis, 2014). It is this definition of SMEs that informs this study.

3. SMEs in Africa

SMEs are the backbone of most economies in Africa. In Sub-Saharan Africa SMEs predominate in the business sector accounting for 60% of the total number of enterprises (Nuwagaba, 2012) and account for 41% of economic growth in those countries (Tumwine *et al.,* 2015). African economies consist of two sectors: the informal and the formal sectors. The informal sector companies tend to operate without business registration or license. SMEs operate in nearly all industrial sectors of the economy and represent more than 90% of formal enterprises and contribute to over 50% of employment and Gross Domestic Product (GDP) (Akinboade, 2015).

In South Africa SMEs are major sources of employment with around 68% of the population working in them (Rabie *et al.,* (2016). They are also a major source of income generation and poverty alleviation (Asah *et al.,* 2015). However many SMEs do not achieve their full potential; with some failing to grow while others fail completely. The failure rate is estimated to be between 70% and 80% (Olawale and Garwe, 2010; Asah *et al.*, 2015) with a 70% failure rate within the first year of operation (Rabie *et al.,* 2016).

In Rwanda SMEs account for 98% of all enterprises and employ nearly half of all private sector workers (Mutandwa *et al.,* (2015).

In Nigeria SMEs contribute 46% of GDP and 25% of employment (Ibrahim and Shariff, 2016).

In Cameroon SMEs account for an estimated 22% of GDP and employ a substantial proportion of the country's labour force (Akinboade, 2015).

In Uganda, in addition to their contribution to GDP, SMEs create employment for skilled, semi-skilled and unskilled people and offer a means of distributing national income more evenly leading to economic growth and development (Kakwa, 2008).

In Ghana approximately 70% of the workforce is employed in micro, small and medium sized enterprises (Chu *et al.,* 2007).

4. SMEs in Kenya

In Kenya micro and small size enterprises (MSEs) contribute to the economy by creating jobs and reducing unemployment (Chu *et al.,* 2007). There are over 41,000 formal MSEs which account for 75% of all formal enterprises (Kenya National Bureau of Statistics (KNBS), 2013). These formal MSEs employ 42% of the Kenyan workforce. However most MSEs operate in the informal sector, known as *jua-kali,* and they employ an estimated 11.1 million people (KNBS, 2013). According to KNBS there are 17 million SMEs registered in Kenya, with 98% of those enterprises contributing 25% of the country's GDP and employing 50% of the workforce.

As with other African economies, it is essential for the Kenya economy that MSEs and SMEs grow and are successful. However with a failure rate of 70% within the first three years of existence success is proving to be difficult to achieve. The next section of the paper looks at how success for SMEs can be defined, what measures of performance are used and what factors are perceived as critical to their success.

5. SME Performance Measurement and Contributing Success and Failure Factors

5.1 SME Performance

Success is associated with performance but how is success defined and how is it measured? Simpson *et al.*, (2012) argue that there is no agreement on how SME business success or performance should be measured or on the critical success factors contributing to that performance. Lau and Lim (1996) defined success as the continuance of business with no losses or having made a profit. They defined failure as the discontinuance of business with losses to creditors and stakeholders. Kesper (2003) defined success for South African SMEs as having survived the first two critical years of existence with the owner having met the majority of her/his goals. Nieman *et al.,* (2003) defined a successful business as one that had been in existence for longer than two years, had a staff of more than five and less than 30, made a profit and expanded in terms of infrastructure and growth. Simpson *et al.*, (2004) argued that success was often viewed in terms of growth or profitability. Growth could be measured in terms of turnover, employment levels or as the percentage change in sales over a year (Yazdanfar and Öhman, 2014).

Traditional measures of organizational performance have tended to be financial such as profitability, and Return on Investment (ROI) (Lo *et al.*, 2016). However it can also be measured in terms of number of employees, market share, turnover, value-added and sales (Rajan and Zingales, 1995). Sandberg (2003) argued that SME performance was the ability to survive, grow and contribute to employment creation and poverty alleviation. Saunila (2016) distinguished between two areas of performance: financial performance and operational performance. The financial performance measures were related to results and included all areas of financial performance. The operational performance measures were those that focused on how results were achieved and included quality, resource utilization and innovation. The following measures of performance identified from the extant literature were used in this study:

(a) Turnover
(b) Net profit
(c) Return on Investment
(d) Employment levels
(e) Sales
(f) Market share
(g) Customer satisfaction
(h) Continued existence
(i) Meeting personal goals
(j) Expanding infrastructure

5.2 SME Critical Success Factors (CSFs)

Simpson *et al.*, (2012) argued that there was no agreement on the CSFs that contributed to SME performance and that the number of variables contributing to performance and, indeed, survival, was extremely large. Pansiri and Temtime (2010), in their survey of 203 SMEs in Botswana observed that the perceived impact of CSFs varied from company to company depending on their size, age, industry sector and management profile. A study of Malaysian SMEs found that the implementation of quality management systems standard ISO 9001 had a positive impact on organizational performance (Sohail and Hoong, 2003). Akinboade (2012), from a survey of SME owner/managers in Cameroon, established that factors that impact SME performance included the age of the business and the age, gender and education level of the owner/manager. He also found that business location impacted turnover growth and that municipal regulation compliance adversely affected turnover growth. Asamoah

(2014), from a study of SME owners and customers in Ghana discovered a positive association between performance and brand association and brand loyalty. Interestingly Chu *et al*. (2007) found that with respect to advertising, entrepreneurs in Kenya relied on word of mouth and free publicity to market their businesses with only 25% of Kenyan entrepreneurs using paid advertising to do this. They also identified government bureaucracy, lack of financing and corruption as the biggest problems facing enterprise owners in Ghana and Kenya.

In a study of 25 Kenyan entrepreneurs, Neshamba (2000) established that the previous work experience of the owner/manager contributed to business success and growth. He also identified knowledge of the market, access to capital, networking, assistance from family members, understanding the needs of the customer and putting in long hours at work as impacting on success. These findings were supported by Pratt (2001), the founding chairman of the Kenya Management Assistance Programme, who found that the availability of capital, previous business experience, family support and possession of business skills were essential for success in Kenya.

5.3 SME Barriers to Success

Oertel and Walgenbach (2012) argued that changes in the top-management teams and partner exits increased the risk of SMEs failing. While Berry *et al.*, (2006) found that those SMEs that used external business advisers such as accountants and consultants were more likely to grow. The more external advice was sought and the wider the range of advice sought was positively related to the growth rate of SMEs. They established that the most sought after advisers were accountants and network contacts with academic advice being only rarely sought. Teng *et al.* (2011) reporting the results of a survey of 178 SMEs in Singapore found that the 4 most important factors perceived by respondents as contributing to their success or failure were: employment, training and retention of high-quality staff; having a prevalence of good products and services; excellent relationships with customers and the availability of top managers with good leadership qualities. Odd-Helge *et al*. (2006), in a study of working practices in Tanzania, established that some of the biggest constraints facing SMEs were government regulations (licenses and permits), high taxes and corruption. Urban and Naidoo (2012) in an investigation into micro, small and medium size enterprises in South Africa found that a lack of operations skills threatened their survival and argued that entrepreneurs should have expertise in all functional areas of a business. Orwa (2007) argued that the biggest challenges facing micro and small size enterprises in the Kenya informal sector (*jua kali*) were cumbersome laws and regulations, lack of access to financial services, such as access to credit, and inadequate access to skills training and technology. The lack of access to credit was also identified by Pansiri and Temtime (2010) as one of the major factors inhibiting the success of small businesses. They also cite managerial deficiencies such as lack of managerial skills and appropriate training as well as a lack of previous management experience as contributing factors to organization failures.

6. Method

A comprehensive literature review was carried out to select control variables and independent variables previously identified in international research studies primarily, but not exclusively, carried out on SMEs in Africa. These variables informed the design of the questionnaire used to survey Kenyan SME owners and managers. The survey population was selected using the Kenya Institute of Management (KIM) SME membership database. All of the surveyed SMEs belonged to the formal sector. The survey instrument was emailed to 200 companies. The aim was to determine how the SMEs measured their business performance and those variables that owner / managers perceived to have most contributed to their business success as well as the perceived barriers they encountered. The strength of perceived success variables and barrier variables were measured using a five point Likert scale. The mean score for each item was calculated with a higher mean score indicating a variable of greater importance in the case of success factors and indicating a larger extent in the case of barriers. A total of 36 questionnaires were returned giving a response rate of 18%. Data were analyses using SPSS v 20 and Microsoft Excel. Data analysis was descriptive due to the small number of respondents making any cross-tabulations with the control variables invalid and unreliable.

7. Results

7.1 Demographics

Of the 36 responses received, 36% were from partnerships and 64% were from sole proprietorship businesses. In the case of these single owner businesses 77% were owned by men and 23% owned by women. Just over a fifth of partnership owned organsations had undergone changes in partners. The SMEs that responded came from all sectors of Kenya industry including manufacturing, retail, education and training, hospitality, construction and telecommunications. The respondents themselves included eight CEOs, eight Managing Directors, three Directors and nine managers. With regards to the education level of respondents, 38% had post graduate level, 36% had university level and 26% college level education. At start-up all respondents were micro or small size enterprises (MSEs) with less than 50 employees, indeed only 5 respondents started with more than 10 employees. Only 7 of the 36 respondent organisations had achieved certification to ISO 9001, the international standard for quality management systems. However, only one of these was a MSE, the others, through growth in employee numbers, were now medium or large size organisations.

7.2 SME Advisers

The most popular sources of advice were entrepreneurs' own network of contacts and market contacts. The least used sources were academics and government support agencies (see table 2 below).

Table 2: Sources of Advice reported by SME owner/managers

Advisers	Number of responses	Always use (%)	Usually use (%)	Sometimes use (%)	Users (%)	Never use (%)	Mean score (range 1-4)
Academics	34	21	32	12	64	36	2.18
External Accountants	36	25	25	25	75	25	2.50
Consultants	36	17	22	42	81	19	2.55
Government support agencies	35	6	26	37	69	31	2.17
Network / social contacts	36	47	28	22	97	3	3.14
Market contacts	36	53	17	19	89	11	3.14
Other	8	38	13	25	76	24	2.75

7.3 Performance Measurement

The most common performance measurement used was customer satisfaction followed by turnover – non-financial measures. These were followed by financial measures: net profit and Return on Investment (ROI). The least used measures were meeting personal goals, expanding infrastructure and market share.

7.4 Growth and Employment

Based on the Kenya classification of enterprises, all respondent firms were micro and small enterprises (MSEs with < 50 employees) at start-up. The least number of employees at start-up was zero and the most was thirty. Of the thirty-six respondent SMEs thirty had grown in terms of increased numbers of employees, five had the same number now as at start-up and only one had reduced their head count. Interestingly, twelve enterprises had grown so big, in terms of the number of employees that they could be reclassified: two MSEs were now medium-size enterprises (50-100 employees) and ten MSEs were now large size enterprises (> 100 employees). The respondents were clearly successful in terms of their growth in the numbers of people they employed.

7.5 Critical Success Factors

Based on the perceptions of the owner/managers of the respondent firms the most important factors contributing to the success of their businesses were maintaining good relationships with customers, having a good product or service, having good marketing skills and creating a brand customers can associate with. Having a high level of education and previous managerial experience were perceived to be the least critical to their success (ref table 3 below).

Table 3: Critical Success Factor for Kenya SMEs

Variable	Mean	Std Deviation
Having a good product or service	4.33	1.04
Being able to recruit high quality staff	4.14	0.83
Being able to retain high quality staff	4.22	0.90
Maintaining good relationships with customers	4.38	0.96
Having good leadership qualities	4.09	1.01
Having good marketing skills	4.28	0.88
Having previous managerial experience	3.74	0.91
Creating a brand that customers associate with	4.28	0.85
Having access to short term credit	3.69	1.04
Having access to long term credit	3.83	1.00
Having sufficient cash available to pay suppliers etc	4.08	0.96
Having good operations skills	4.17	0.85
Having access to appropriate training	4.19	0.82
Having government policies that foster an environment that is favourable to SMEs	4.08	0.90
Operating in a corruption free environment	4.22	0.79
Being able to access business advisors	3.88	0.91
Having a high level of education	3.47	0.90

Source: Authors own data

7.6 SME Barriers to Success

Based on the perceptions of the respondent firms' owner/managers the biggest barriers to the continuing success of their businesses were high taxes, too much government regulation and corruption in municipal government. Not having ISO 9001 certification was not viewed as a barrier to success perhaps explaining the low implementation levels of the international quality management systems standard among the study's respondent SMEs (ref table 4 below).

Table 4: Barriers to Kenya SMEs' Success

Variable	Mean	Std Deviation
Corruption of municipal government	3.86	1.19
Inability to recruit quality staff	3.55	1.13
Lack of operations skills	3.33	1.30
Lack of managerial skills	3.38	1.10
Lack of access to finance	3.83	1.23
Lack of product or service innovation	3.66	1.24
Change in ownership (if applicable)	2.44	1.18
Lack of managerial experience	3.16	1.29
Lack of business advisors	2.87	0.99
Lack of training opportunities	3.38	1.15
Not having ISO quality certification	2.33	1.21
Poor location of business	3.38	1.55
Lack of government support	3.63	1.35
Too much government regulation	3.91	1.05
High taxes	4.50	0.77
Lack of education	2.94	1.39

Source: Authors own data

8. Discussion

SME success is an issue for nearly every country but particularly for Kenya where the failure rate is 70% within the first three years of operation. The SMEs reported in this study were, based on the growth measure of the number of employees and the fact that they are still in business, successful enterprises. Some hd grown so much that they could no longer be classed as SMEs.

The results also showed that there was a move away from reliance solely on financial measures as a means of measuring performance. It has long been argued in the business literature that the healthiest companies are those that have high customer satisfaction levels because of the link with customer loyalty and repeat business (Heskett *et al*. 2008). Indeed the link between quality goods and services, customer satisfaction, loyalty and profits is reflected in both performance measures and the factors perceived to being critical to SME success with maintaining good customer relationships and having a good product or service deemed to be the most critical factors. Despite this recognition of the need to have quality goods and services only 7 SMEs (the biggest respondents based on the number of employees) had achieved ISO 9001 certification perhaps reflecting the disproportionate cost and bureaucratic burden associated with implementing that standard in smaller companies as well as the lack of certification not hindering business dealings. Interestingly, operating in a corruption free environment ranks highly as does having government policies that foster an environment favourable to SMEs.

Despite all the respondents being college or university educated, having a high level of education was the least important factor impacting success along with having previous managerial experience, contradicting previous studies cited in the literature above.

Given the African context of this study it is not surprising to find that high taxes, too much government regulation and corruption in municipal government were seen as the biggest barriers to success. Corruption is an added business cost that is likely to affect competitiveness, particularly in international markets. In Uganda, for example, where the majority of firms pay bribes, these account for around 8% of total costs depending on the extent an enterprise has to deal with public officials (Svensson, 2003). It is perhaps not surprising given the corruption in municipal government that the least used advisers were government support agencies. With regards to government regulations, the World Bank 2017 rankings of 190 countries ranks Kenya 92nd with regards to the ease of doing business, 116th for starting a business, 125th for paying taxes but 25th with regards to getting credit (World Bank, 2017) However, problems accessing finance were seen as the fourth biggest obstacle to SME success by respondents in this study.

9. Implications

Many of the problems facing SMEs in Kenya are in the external business environment over which they have very little control. It is for the Kenya Government to tackle corruption, have a simple and fair system of taxation and to ensure that policies and regulations are in place to create a business climate favourable to SMEs success. The more successful SMEs are then the more people they will employ. This impacts the national economy by reducing unemployment, creating wealth and contributing to increased income tax revenues for government.

From an owner/ manager perspective there is a need for them to have good marketing skills and to use them to market their quality goods and services. Customer relationship management (CRM) is also important for repeat purchases

10. Limitations and future research agenda

All the respondents in this study were from the formal sector of the Kenya economy. This means that the informal sector or *jua-kali* was not represented. This is a major limitation given that most micro and small organisations operate in that sector. To increase the reliability and validity of the data future research must include representatives from that sector. However, by its very nature, unlicensed and unregistered, this may prove difficult.

The other main limitation of this study is the small response rate of 18% (n=36). This has meant that a full statistical analysis of the data has not been possible.

This paper represents an exploratory study of Kenya SMEs. The aim is to develop the questionnaire and to expand the survey to include more SMEs from both economy sectors in Kenya and the wider East Africa region in order to achieve more valid and reliable data.

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