

## Strategic Management Accounting Practices and Financial Performance of Small and Medium Manufacturing Enterprises in Nairobi City County, Kenya

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### Abstract

*Previous studies acknowledge that small and medium-sized enterprises (SMEs) are key drivers to Kenya's economic development. Many of these SMEs face persistent constraints and do not realize their full potential, with many failing within their first three years of operation. A possible cause for the high failure rate is poor financial performance. Existing literature highlights one remedy as the use of strategic management accounting practices. This paper investigated the influence of strategic management accounting practices (SMAPs) on the financial performance of small and medium manufacturing enterprises (SMMEs) in Nairobi City County, Kenya. The study used self-reporting opinion questions on Return on Investments (ROI), Return on Assets (ROA) and net profit margin as financial measures. A descriptive research design was used. Target population was 693 SMMEs in Nairobi. Data was collected through a self-administered cross-sectional survey. Questionnaires were administered to a sample of 254 SMMEs with 156 usable responses. Data was analyzed using structural equation modelling to explain the relationships among multiple variables for SMAPs and financial performance. Results of hypothesis testing revealed that SMAPs significantly influence financial performance ( $\chi^2 = 612.82$ ,  $DF = 171$ ,  $p\text{-value} = 0.000$ ,  $CMIN/DF (x^2 /df) = 3.584$ ,  $RMSEA = 0.114$ ,  $IFI = 0.857$ ,  $CFI = 0.856$ ,  $NFI = 0.819$ ,  $GFI = 0.806$ ,  $AGFI = 0.751$ ), where the model explains 43.7% in the variations on financial performance of SMMEs. Results suggest that the financial performance of SMMEs can be improved by deploying SMAPs. The study recommends that SMMEs should be encouraged to adopt SMAPs through policy and practice.*

**Keywords:** Management accounting practices, Financial Performance, SMMEs.

### Introduction

Small and medium-sized enterprises (SMEs) have been acknowledged worldwide as contributors to economic development and revenue generation in both developed and developing countries. They account for much of the financial performance reported in businesses (Deku et al., 2021). However, increased globalization has intensified competition increasing uncertainty about their profitability and financial performance. These challenges, cause the firms to remain unprofitable. Persistent poor financial performance results in high failure rates and closure of many of these businesses.

In Kenya, the manufacturing sector is important for economic growth and is a major source of employment and income generation (KIE, 2018). Approximately 80% of the manufacturing companies are SMEs, with industries across all sectors of the economy. Kenya's Vision 2030 underlines the SMMEs importance as they contribute about 40% of the country's GDP and 80% of total employment (KAM, 2019). However, prior studies indicate that despite their enormous potential, SMMEs have been reporting low profitability and poor financial performance with many closing down (Kiveu et al., 2019). Kenya's Economic Survey (Kenya National Bureau of Statistics (KNBS), 2021) reports that the share of the manufacturing sector to GDP declined from 7.9% in 2019 to 7.6% in 2020. This decline was attributed to Covid-19 pandemic lockdowns, which caused companies to operate below capacity and report reduced sales turnover.

To address the SME poor performance, recent studies have shown that strategic management accounting practices (SMAPs) are a possible intervention in SME sustainability and performance (Ahmad, 2017). SMAPs can provide high-quality management accounting information (Edson et al., 2016) that is timely for decision-making and improvement of the organization's profitability and financial performance (Adu-gyamfi et al., 2020). Firms that apply SMAPs are likely to have best practices that provide valuable information that result in superior performance and remain competitive (Msomi and Nyide, 2020). SMAPs are modern-day management accounting practices (MAPs) that link operations with the firm's objectives, strategies and management accounting (Emiaso & Egbunike, 2018). Generally, MAPs provide timely and accurate information, enabling better and more effective decision-making for planning and control (Kalifa et al., 2020). However, the traditional approach of MAPs is reported not to be customer focused (Malik & Malik, 2011). SMAPs support and promote mechanisms of implementing quality information that emphasizes customer focus and external environment of a business (Oyewo, 2021) resulting in improved financial performance and competitive advantage.

### **Research Problem**

Despite the important role played by SMMEs in Kenya's economic development, they face serious challenges such as increased global competition and rapid technological changes (Ministry of Industrialization, Trade and Development, 2020). These challenges lead to poor financial performance and failure rates of more than 75% of the SMMEs within the first three years of business (Riro, 2022). Due to SME's contribution to employment and wealth creation (Douglas et al., 2017), the government places high expectations on their performance. Accordingly, many policy interventions and support programs for SMEs which include the creation of an enabling business environment (Kenya National Bureau of Statistics (KNBS), 2018), training (Rabie et al., 2016) and tax incentives (Yoshino & Taghizadeh-Hesary, 2016) have been introduced. Nonetheless, despite the past policy interventions, SMMEs still face challenges that impede their productivity and financial performance, competitiveness, and sustainability. This study therefore, examines the influence of strategic management accounting practices and financial performance of SMMEs in Nairobi City County, Kenya.

### **Literature Review**

This section reviews the theory that anchors the research on SMAPs and provides an empirical literature on SMAPs constructs and their influence on financial performance.

## Theoretical Review

This study was anchored on the contingency theory which states that there is no universal way of directing or making decisions that fit all organizations but that each organization chooses what is best for it (Abba et al., 2018). Previous researchers submit that under contingency theory approach, there is no acceptable accounting information system that fits all businesses. Each organization finds its suitable MAPs based on its contingent factors (Drury, 2017) and its environment. Firms must carefully analyze their environment and internal characteristics and adopt appropriate accounting practices that fit their businesses and align their strategies with the external environment to achieve a strategic fit, such as financial performance.

## Conceptual Framework

Figure 1 presents the conceptual framework which explains the hypothesized relationships between the study variables. The three independent variables include, competitive position analysis, customer value analysis and value chain analysis. SMAPs represent the endogenous variable, while financial performance was the dependent variable.

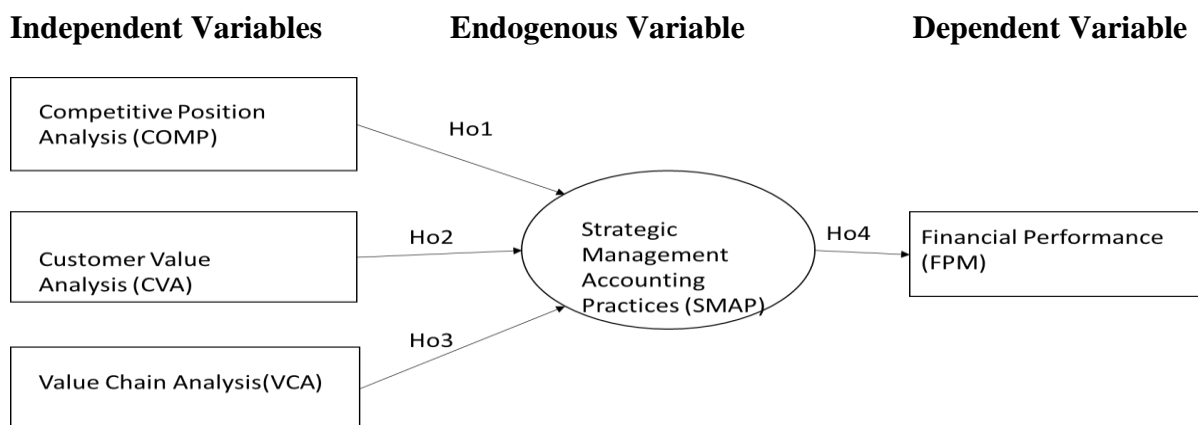


Figure 1: Conceptual Framework

Source: Authors (2023)

Based on this conceptual framework, the following null hypothesis was tested:

*H0: There is no statistically significant influence of strategic management accounting practices on the financial performance of SMMEs in Nairobi City County, Kenya.*

## Empirical Review

Strategic management accounting practices are contemporary MAPs which are strategic in nature as they link firm operations with its objectives, strategies and management accounting (Emiaso & Egbunike, 2018). Further, SMAPs integrate the firm's financial and non-financial information to meet present-day business management needs on strategy application and implementation (Kalkhouran, 2015). SMAPs are broader than traditional MAPs and are largely customer-focused (Ojra, 2014). The conceptualised SMAPs include competitive position analysis, customer value analysis and value chain analysis.

### *Competitive Position Analysis*

Firms perform competitive position analysis to study their competitors' behaviour and actions and to predict the competitors' future actions (Adom et al., 2016). The results of the analysis help a firm to identify the strategies of its competitors (Kornchai & Na-kalasinhu, 2020), assess the firm's own position relative to its main competitors and to formulate its own plans and strategies against the competition. Msomi and Nyide (2019) suggest that competition influences the adoption of relevant and most strategic MAPs for competitive advantage. Irungu and Arasa (2017) studied the factors influencing organizational competitiveness among SMEs in Nairobi and established that SME managers were concerned with increased profitability and performance for competitive advantage. The study recommended the use of various strategies for relevance and sustainable competitive advantage. Thus it is hypothesized that:

*Ho<sub>1</sub>: Competitive position analysis has a statistically significant influence on the financial performance of SMMEs in Nairobi County, Kenya.*

### *Customer Value Analysis*

Customer value analysis involves the analysis of the degree of customer satisfaction and considers the desired end state of what the customer wants in a product or a service. Further, it is a strategic commitment that creates value for customers and the firm in terms of long-term customer relationships and profits. Fourie (2019) states that customer value is a trade-off between the price paid and the quality and benefits received from that product or service. Customers assess the usefulness they gain from products or services and the price paid (Prastiwi et al., 2018). A firm must, therefore, set a price for its product that the customer would be willing to pay for the perceived benefit. Thus, it is hypothesized that:

*Ho<sub>2</sub>: Customer Value analysis has a statistically significant influence on the financial performance of SMMEs in Nairobi City County, Kenya.*

### *Value Chain Analysis*

Value-chain analysis involves an organization's traditional cost analysis and further extending it to suppliers and customers to take advantage of potential synergies and alliances (Sedevich-fons, 2018). Accounting information is an important component of the value chain analysis (Kirli & Gumus, 2011). Roko and Opusunju (2016) examined the impact of the value chain on the performance of Agro-allied SMEs in Niger State, Nigeria. The findings revealed a significant relation between value chain and performance. Further, the primary and secondary activities of the value chain were found to contribute significantly to the performance of these SMEs. The following hypothesis was therefore tested:

*Ho<sub>3</sub>: Value chain analysis has a statistically significant influence on the financial performance of SMMEs in Nairobi City County, Kenya.*

### *Financial Performance*

Financial performance measures are quantitative measures calculated from a firm's available financial statements (Ahmad, 2012). These measures include return on equity (ROE), return on assets (ROA), return on investments (ROI), and other established measures (Taticchi et al., 2010). These performance measures mostly apply to large companies where extensive

research on financial performance measurement systems has been done (Anggadwita & Mustafid, 2014), but are not always appropriate for SMEs. Where challenges are confronted in getting financial statements or objective measures such as ROE, ROA and ROI, perceived financial performance indicators such as self-reporting opinion questions are supported (Onyiego, 2019). Following prior literature on SME financial performance, this study used self-reporting opinion questions on ROI, ROA and net profit margin as profitability measures (Korir, Naibei, & Cheruiyot, 2021). Thus, it was hypothesized that:

*Ho<sub>4</sub>: There is a significant positive relationship between strategic management accounting practices and the financial performance of SMMEs in Nairobi City County, Kenya.*

## **Methodology**

This study adopted a positivist research philosophy approach. A descriptive research design was used. Target population was 693 SMMEs in Nairobi comprising of various manufacturing sub-sectors divided into 12 categories and listed in the Kenya Association of Manufacturers directory (KAM, 2019). A disproportionate stratified random sampling procedure was used to ensure reasonable representation (Tracy & Carkin, 2014). A sample of 254 SMMEs was calculated using an online calculator for structural equation modelling (Soper, 2021). The manager/accountant in each SMME was the unit of observation. Data was gathered using a structured questionnaire and analyzed through Structural Equation Modelling (SEM) using R-Statistics software to test the study hypotheses. SEM simultaneously estimates a series of inter-related relationships.

## **The Study Results**

Out of 254 questionnaires administered to managers and accountants, 156 questionnaires were returned representing a response rate of 61%. The respondent managers were 48.7%, accountants 44.9% while 6.4% represented owners. Male respondents were 63% and 37% female. With respect to age, 24.3% were above 40 years, 53.2% were between 30-39 years and 22.4% were between 22-29 years. In education, 54.5% of total respondents had a bachelor's degree, 19.2% had masters or doctorate degrees while 18.6% were diploma holders. Only 7.7% had high school education. Limited companies were 81.4% SMMEs, partnerships 9% and sole proprietorships and family businesses were 9.6%. The 12 manufacturing sectors were sufficiently represented with the highest being Food and Beverage sector at 16%, while leather and footwear was the lowest at 2.6%. About 35% SMMEs have existed for over 20 years, 21.2% for more than 10 years and 2.6% for less than 3 years. SMMEs with total assets of over 20 million were 36%, 19.2% had 15-20 million and 44.8% with less than 15 million. About 58% firms had 50-99 employees while 42% had 11-49 employees. SMMEs with over 5 products were 54%, 34% had 2-5 products and 12% had 1 product. For sales, 39% had over Kshs10 million, 30% had Kshs5-10 million and 31% had below Kshs 5 million.

## **Descriptive Statistics**

The study compared the means of the variables describing the SMAPs dimensions. Respondents indicated the extent of their agreement with statements on a scale of 1 to 5 (strongly disagree to strongly agree). Table 1 shows the findings of descriptive analysis for SMAPs. The mean scores ranged between 4.315 - 4.423 showing that most of the respondents strongly agreed that there are benefits to using SMA practices. Value chain analysis had the highest mean score of 4.423.

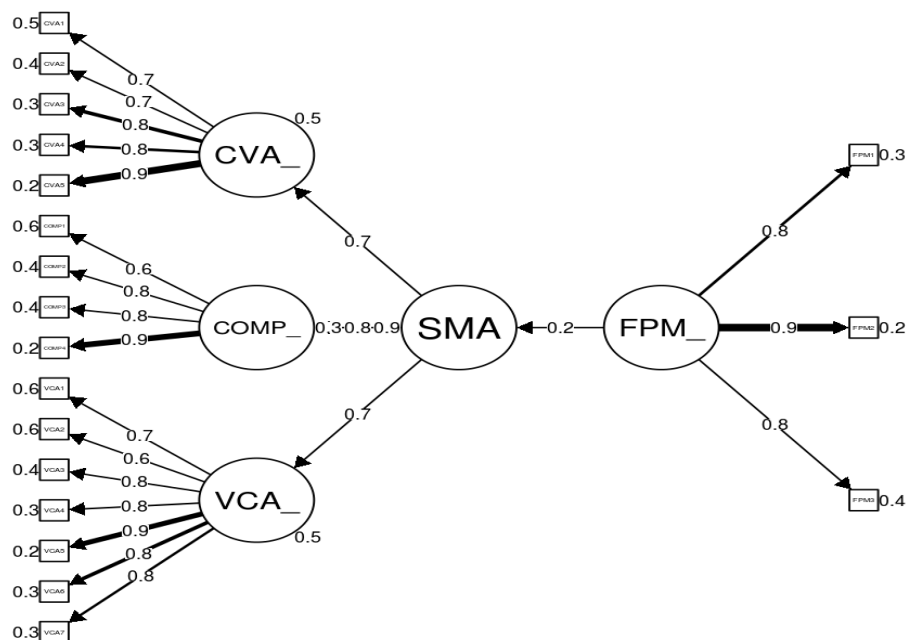
Table 1. Mean statistics for SMA Practices and Financial Performance

Descriptive Statistics											
	N	Minimum	Maximum	Mean	Std. Deviation	Variance	Skewness	Kurtosis			
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
CVA	156	1	5	4.412	0.035	0.537	0.288	-2.473	0.157	12.769	0.313
COMP	156	1	5	4.315	0.038	0.585	0.342	-2.190	0.157	8.880	0.313
VCA	156	1	5	4.423	0.034	0.530	0.281	-2.703	0.157	13.828	0.313
FPM	156	1	5	3.759	0.061	0.951	0.905	-0.857	0.157	0.844	0.313

Source: Authors (2023)

**SEM for SMAPs and Financial Performance of SMMEs**

The Partial Least Squares Structural Equation Model (PLS-SEM) was used to explain the relationships among the multiple variables for SMAPs and financial performance as shown in Figure 2.



Chi-square ( $\chi^2$ ) = 612.82, DF = 171, P-VALUE = 0.000, CMIN/DF ( $\chi^2$  /df = 3.584, RMSEA = 0.114, IFI= 0.857, CFI= 0.856, NFI= 0.819, GFI =0.806, AGFI=0.751

Figure 2. SEM Model for SMA Practices and Financial Performance

Table 2 gives a summary of the various measures of fit indices used to check the influence of SMAP practices on financial performance. The fit indices signified a perfect model fit of chi-square ( $\chi^2$ ) = 612.82, DF = 171, p-value = 0.000, CMIN/DF ( $\chi^2$  /df = 3.584, RMSEA = 0.114, IFI= 0.857, CFI= 0.856, NFI= 0.819, GFI =0.806, AGFI=0.751. The p-value was 0.000, hence, the conclusion that the model fitted the data perfectly well.

Table 2: Measures of Fit of Strategic Management Accounting Practices on Financial Performance

Fit Measures Parameter	Fit Measures Indicators	Interpretation	This Model Results	Comment
Chi-square ( $\chi^2$ )	<0.5	Acceptable	612.82	Acceptable fit
	>0.5	Acceptable fit		
CMIN/DF ( $\chi^2$ /df)	<1	Over fit	3.584	Good Fit
	1 – 3	Good fit		
	>3	Over fit		
RMSEA	0<=	Exact fit	0.114	Reasonable
	About 0.05<=	Close fit		
	About 0.08<=	Reasonable fit		
	>0.1	Over fit		
IFI	0 – 1	Fit	0.857	Very Good
	Close to 1	Very good fit		
	>1	Over fit		
CFI	0 – 1	Fit	0.865	Very Good
	Close to 1	Very good fit		
	>1	Over fit		
NFI	0 – 1	Fit	0.856	Very Good
	Close to 1	Very good fit		
	>1	Over fit		
GFI	0 – 1	Fit	0.806	Very Good
	Close to 1	Very good fit		
	>1	Over fit		
AGFI	0 – 1	Very good fit	0.751	Very Good Fit
	1	Perfect fit		
	>1	Over fit		

Source: Authors (2023)

### ***R-Square Values for Strategic Management Accounting Practices and Financial Performance***

The R-squared value for SMAPs and financial performance was 0.437 as shown in Table 3. This means that SMAPs explain 43.7% of the variations in financial performance. For every

SMAP increase in usage, financial performance increases by 0.437 units. The variances explained were below a moderate variance of 0.50 as recommended by Hair et al. (2017) and therefore fitted on to the data weakly.

Table 3: R-Square Values for SMAP Practices and Financial Performance

Variable	R-Square	Variable	R-Square
CVA1	0.517	VCA4	0.654
CVA2	0.551	VCA5	0.751
CVA3	0.712	VCA6	0.707
CVA4	0.685	VCA7	0.672
CVA5	0.813	FPM1	0.678
COMP1	0.380	FPM2	0.834
COMP2	0.623	FPM3	0.631
COMP3	0.649	CVA	0.507
COMP4	0.775	COMP	0.653
VCA1	0.441	VCA	0.528
VCA2	0.385	SMA	0.058
VCA3	0.619	FPM	0.437

Source: Authors (2023)

### Hypothesis Testing: Direct Relationship

Table 4 shows the path coefficients for the influence of SMAPs on financial performance after conducting hypothesis testing using SEM. All the paths reflect the constructs and their associated hypotheses. The null hypothesis for the SMAPs and financial performance was  $H_0$ : *There is no statistically significant influence of strategic management accounting practices on financial performance of SMMEs in Nairobi.* The path between CVA and SMA was significant (path coefficient = 0.000,  $p < 0.05$ ); between COMP and SMA was significant (path coefficient = 0.000,  $p < 0.05$ ) and between VCA and SMA was significant (Path coefficient = 0.000,  $p < 0.05$ ). The path between SMA and FPM was 0.001,  $p < 0.05$ . The hypothesis was therefore rejected as the path analysis had a  $p\_value = 0.001$   $p < 0.05$ .

Table 4. Path Coefficients for SMAPs on Financial Performance

LHS	PATH	RHS	ESTIMATE	STD ERROR	Z-SCORE	P-VALUE	CI-LOWER	CI-UPPER
FPM	→	SMA	0.241	0.074	3.231	0.001	0.095	0.387
SMA	→	CVA	0.712	0.051	13.891	0.000	0.612	0.813
SMA	→	COMP	0.808	0.050	16.053	0.000	0.709	0.907
SMA	→	VCA	0.727	0.051	14.339	0.000	0.627	0.826

Source: Authors (2023)

From the summary of the path analysis shown in Table 4, the output is presented in Table 5. The constructs and their associated hypotheses were proved by the findings of this study.

Table 5: Hypothesis Testing Conclusion for SMA Practices and Financial Performance

Hypothesis		p-value	Comment
Ho	There is no statistically significant influence of strategic management accounting practices on financial performance of SMMEs in Nairobi City County	0.001	Ho Rejected
Ho1	Customer value analysis has a statistically significant influence on the financial performance of SMMEs in Nairobi	0.000	Ho1 not rejected
Ho2	Competitive position monitoring has a statistically significant influence on the financial performance of SMMEs in Nairobi	0.000	Ho2 not rejected
Ho3	Value chain analysis has a statistically significant influence on the financial performance of SMMEs in Nairobi	0.000	Ho3 not rejected

Source: Researcher (2023)

Consequently, from the results in Table 5, the null hypothesis  $H_0$ : There is no statistically significant influence of strategic management accounting practices on financial performance of SMMEs in Nairobi City County was rejected. The path analysis had a  $p\_value = 0.001$   $p < 0.05$ . The structural equation model was therefore:

$$SMAPs = 0.712CVA + 0.808COMP + 0.727VCA + \text{Error term}$$

$$FPM = 0.241SMA + \text{Error term}$$

### Discussion of Findings

This study examined the influence of strategic management accounting practices on the financial performance of SMMEs in Nairobi. The null hypothesis  $H_0$  was: *There is no statistically significant influence of strategic management accounting practices on the financial performance of SMEs in Nairobi*. The results established that SMA practices influence the financial performance of SMMEs as they had an  $R^2$  of 0.437 indicating they accounted for 43.7% variance in the financial performance of SMEs. However, even though this is a weak fit because it is below 0.5 (Hair, Risher, & Ringle, 2018), it nevertheless shows that SMA practices have an influence on the financial performance of the business. The path analysis results and the hypotheses testing showed that all the paths for the SMA constructs and associated hypotheses were proved by the findings and the null hypothesis was rejected with a  $p\_value$  of 0.001,  $p < 0.05$ . These findings agree with the findings that adoption of SMAPs has an effect on the firm's performance (Alsoboa et al., 2015; Kariuki & Samuel, 2016; Nik Abdullah et al., 2022). Further, the results are consistent with previous

studies (Etim et al., 2020; Me, 2018; Pasch, 2019; Waweru & Omwenga, 2015) that there is a positive correlation between the independent variables (SMA) and the dependent variable, financial performance.

The results confirmed prior researchers findings that SMA practices enable firms to focus on customers and external environment for competitive positioning (Juras, 2014; Ojra, 2016). Value chain analysis focuses on product design and services for improvement and better performance as well as undertaking product cost analysis and evaluating alternatives to ensure sustainability (Nartey & van der Poll, 2021). This shows that SMAPs provide appropriate information for decision-making in performance improvement and focusing on both internal and external environments. In contrast, some studies suggest that SMEs in developing countries have a low adoption of more sophisticated information from management accounting systems such as SMA practices (Amanollah et al., 2017; Arunruangsilert & Chonglertham, 2017; Lopez & Hiebl, 2015). The low level of adoption of SMA practices is usually due to a lack of adequate resources, insufficient management accounting skills to fulfil SMA requirements and lack of a uniform definition of SMA practices and unclear methods and techniques of SMA practices (Alamri 2019; Lopez & Hiebl 2015).

### **Conclusion and Recommendations**

This study sought to investigate the influence of SMAPs on SMMEs' financial performance. The results showed that SMAPs had a 43.7% influence in the variations on the financial performance of SMMEs in Nairobi. SMMEs should therefore, adopt SMAPs to improve financial performance and create more employment and wealth for the country. Further, customer value analysis, competitive position monitoring and value chain analysis are strategic management accounting practices which can improve financial performance. SMMEs can be assisted to implement and use SMAPs to enhance financial performance for sustainable development goals. In addition, the government and other stakeholders can use these results to assist the SMMEs to improve their productivity. Further, the SMMEs can use SMAPs for better plans and decisions on how to utilize the Hustler Fund to grow and improve their financial performance.

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