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Original Research Article

Assessing the Influence of Accounting Outsourcing on Financial Performance of Small and Medium Enterprises in Thika Subcounty, Kenya

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HATASO, USA

Assessing the Influence of Accounting Outsourcing on Financial Performance of Small and Medium Enterprises in Thika Subcounty, Kenya

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Abstract

Globally, small and medium sized enterprises (SMEs) have been found to significantly contribute to the gross domestic product (GDP) in developing nations as well as to employment. In Kenya, the SMEs have the potential of raising many citizens to the mainstream economy. Although the SMEs contribute toward economic development as well as to employment in Kenya, their financial performance is still wanting, which is evidenced by the high collapse rate of SMEs. This research project assessed the influence of accounting outsourcing (AO) on financial performance of SMEs. The study used a descriptive design, and the number of SMEs that formed the population of study was 8605 in Thika subcounty. The sample size was therefore 368 SMEs, which were sampled using stratified and simple random sampling. The study adopted a questionnaire to collect data, and the Cronbach alpha coefficient was employed for testing of reliability. Descriptive and inferential statistics were used in analyzing the collected data with the assistance of statistical packages of social science (SPSS) version 23. The relationship between influences of AO and its effect on financial performance of SMEs were established through a simple regression model. The results of this study showed a significant positive association between the explanatory variables and the financial performance of SMEs. The study concludes that influences of AO have significant influence on SMEs financial performance. The study recommended that managers and owners of SMEs should seek service from qualified accountants as this may increase the quality of financial records and may improve their SMEs financial performance.

Keywords: Small and medium enterprises; Accounting outsourcing; Financial performance.

1. INTRODUCTION

Globally, small and medium sized enterprises (SMEs) have been found to significantly contribute to the gross domestic product (GDP) in developing countries as well as to employment (Ebrahim, Ahmed, and Taha, 2010). Significant growth and economic development are witnessed in most emerging economies due to contribution of the SMEs. A study carried out by Rathnasiri (2014) showed that in Europe 75% of the workforce is employed by SMEs. A study carried out in Ghana showed that SMEs are involved in generation of revenue of the governments through the payment of income tax, which arises from the profits they make, the dividends and wages they offer to the households as well as assisting in reducing through fiscal transfers and salaries they give to their employees (Amoako, 2013).

In Kenya, the SMEs have the potential of raising many citizens to the mainstream economy (Koech, 2015). A recognition that has made the Government of Kenya (GoK) to incorporate the strengthening of SMEs in Kenya Vision 2030 through increasing their yield, innovation, and performance (Ministry of Planning, National Development & Vision 2030 [MPNDV2030], 2007). The SMEs sector in Kenya has experienced a tremendous growth of enterprises from micro to SMEs to a point that it spreads in all economic sectors, offering a major employment opportunity as well as generating more economic development in the country (Republic of Kenya, [RoK], 2010).

The Kenyan SMEs, which are considered to be in the private sector, have been able to engage majority of citizens who have not been engaged by the public sector and nonprofit making organizations (RoK, 2013). According to a report of African Economic Outlook 2011 as cited by Mwangi (2014), 80% of the total jobs in Kenya are from the SMEs sector; the sector has ensured increase in employment creation and contributes

20% of the GDP. The contribution of SMEs toward employment, GDP, and to the country's revenue and capital base depends on SMEs financial performance (Ebrahim, Ahmed, and Taha, 2010). Return on investment and earnings per share (EPS) are used to measure the financial performance of SMEs.

According to Feizpour and Jamali (2009) when SMEs want to grow, they should focus on core activities for efficiency matters and outsource to compensate for resource (competencies) gaps (Mirbargkar, 2009). The utilization of accounting outsourcing (AO) practices offers more assistance for performance and business sustainability for SMEs (Jayabalan *et al.*, 2009). According to Blackburn, Carey, and Tanewski (2010), SMEs are open to a lot of danger due to lack of some routines and capabilities for existence while they are forced to find ways of improving firm performance. In this context of accounting function, outsourcing is a chance for smaller firms to maintain a lead beyond others in a surrounding where there are other competing firms (Jayabalan *et al.*, 2009). Most SMEs may not have enough resources and competence to do their professional work internally. Therefore, going out to look for professionalism becomes the main factor of outsourcing (Jayabalan *et al.*, 2009). Thus, SMEs should engage external accountants, through AO to provide accounting functions to achieve performance.

1.1. Statement of the Problem

SMEs are said to be the main drivers to economic development for developing countries. Indeed, they have been identified as the mover of Kenya vision 2030 (MPNDV2030, 2007). However, SMEs in Kenya are facing systematic decline as evidenced by the high collapse rate of SMEs with over 60% of SMEs shutting down in their first year of offering service, forty percent (40%) within the second year, and sixty-six percent (66%) by the sixth year, only 10 to 15% survive to a third generation, this failure has turned to be the "deathbed" of SMEs in Kenya (Musanga and Ombui, 2015). Indeed, SMEs in urban towns such as Thika are equally affected. Thika subcounty is an industrial town with many SMEs (County Government of Kiambu, 2015). According to the records from the Thika subcounty offices, many of SMEs collapse a few months after their establishment. It is therefore of great value that a study of this nature be conducted in Thika subcounty.

According to Germain (2010), it is shown that most of SMEs collapse because of poor or lack of proper accounting practices. A study carried out by Mutua (2015) on accounting practices and growth of SMEs showed that SMEs do not maintain proper accounting books and do not hire professional accountants due to cost. The study showed only 52% of SMEs are able to maintain accounting records with the rest not able to keep accounting records which is an indicator of poor accounting practices. A study by Muchira (2012) on accounting practices of SMEs showed that only 21% of SMEs prepare financial statements to the final stage and 40% do not prepare financial statements at all. These can be attributed to be the failure of many SMEs. The cause for the failure of many SMEs a few months after they have started should be investigated with a view of coming up with a way out to enable them survive for a longer period.

Most of the empirical studies on the performance of SMEs have mainly focused on well-established enterprises (Zheng, O'Neill, and Morrison, 2009). However, there is scanty information concerning assessment of AO on financial performance of SMEs in Kenya. This is why this research wishes to provide recommendations on approaches to overcoming problems faced by SMEs in their financial performance, by suggesting detailed systems influencing the accounting practice of SMEs to overcome the prevailing problems and in particular AO.

1.2. Objective

The objective of this study was assessing influences of AO on financial performance of small and medium enterprises (SMEs) in Thika subcounty.

2. LITERATURE REVIEW

This section presents a theoretical literature and empirical review, relevant to the study.

2.1. Theoretical Review

2.1.1. Transaction Cost Economics Perspective

Transaction cost economics (TCE) perspective has become a standard framework to describe why some firms perform their accounting functions within the firm, while other firms outsource such functions to

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professional accountants (Everaert, Sarens, and Rommel, 2010). Most likely the outsourcing decision is made based on the transaction cost of certain accounting functions to the firms (McIvor, 2009). TCE is used as a theoretical framework in order to know how professional accountant can help in reducing the transaction cost of SMEs (Everaert, Sarens, and Rommel, 2010). Consequently, TCE explains how firms consider the relative cost of transactions utilizing their own staff on one hand and external (professional) accountants on the other hand (Hamzah *et al.*, 2010). This implies that transaction cost is related with any function on key elements such as asset specificity, the behavioral uncertainty, environmental uncertainty, and frequency of the transactions. Those factors predict whether a function is most efficiently performed internally or outsourced (Reeves, Caliskan, and Ozcan, 2010). In addition, TCE also extends trust as another important factor that influences transaction costs and outsourcing decisions (Greenberg, Greenberg, and Antonucci, 2008). TCE perspective was important in this research because of the cost of AO in comparison to engaging own professional accountants.

2.2. Empirical Review

2.2.1. Influence of AO on Firm Performance

The study by Jayabalan *et al.* (2009) on outsourcing of accounting functions among SME companies in Malaysia showed several aspects of outsourcing practices among SMEs involving the accounting functions. The study concluded that outsourcing of accounting functions is an alternative for SMEs so as to sustain a competitive advantage in the business world environment because outsourcing could reduce the burden borne by SMEs.

A study by Desai (2007) on finance and AO predicted that presence of AO factors would provide a firm with a competitive advantage. AO plays a major role in determining the selection of organizational form in the future and therefore making it vital to cultivate an early understanding of this industry. Although the study addressed issues in accounting literature to advance in the knowledge of accounting concept and the outsourcing of accounting services, it fell short of clearly explaining how AO influenced the performance of SMEs. The same issues have not been addressed previously; a gap the present study sought to fill.

2.2.2. Financial Performance of SMEs

Performance of an enterprise comprises of four elements: customer-based performance, performance on finance, performance on market, and performance on human resource. Financial performance is all about adding value to the owners of the enterprise, which is measured by measures such as profit after tax, Return on Assets (ROA), Return on Equity (ROE), and EPS (Allam, Raza, and Akram, 2011). Performance is a continuous process that comprises managing the conditions for which an organization can be assessed (Duranti and Thibodeau, 2001); these conditions involve the internal control measures like the control of business expenses and ability to satisfy staff. A business is said to be performing effectively if it is able to show returns on profit, it is able to improve on facilities, and its market share increases (Fitzgerald *et al.*, 2006).

A study carried by Odero (2014) was able to show that the financial performance of SMEs is affected positively by the Accounting Information System quality. Performance measures could be both qualitative and quantitative. Performance measures give the way forward in attaining the organizational goal. A research by Guest, Michie, and Conway (2003) identified performance measures as ROA, ROE, turnover, and profit before tax (PBT). Evaluation of performance involves assessing the relationship between internal operations, external activities, and environment. Internal performance is all about accounting data. Financial ratios are also used in determination of firms' performance. The most common ratios are liquidity ratios, debt ratios, activity ratios, and investment ratios (Kamau, 2015).

3. METHODS

The study was carried out in Thika subcounty, Central Kenya. The target population of the study was 8605 SMEs registered in Thika subcounty under county government classified as manufacturing, retail, and other services. The researcher gathered the evidence from primary and secondary sources. Questionnaires issued to the managers or owners of SMEs provided the data from primary source, while copies of financial statements from the office of managers or owners of SMEs were the sources of secondary data. The sample size was selected through stratified random sampling.

According to Saunders, Lewis, and Thornhill (2012), the sample size of a data where all the total items are below 10,000 is determined by the following formula:

$$n_1 = \frac{n_2}{1+\left(\frac{n_2}{N}\right)}$$

where n_1 = adjusted minimum sample size
n_2 = minimum sample size
N = the entire population

The minimum sample size n is computed by using the following formula:

$$n_2 = p\% \times q\% \times \frac{z^2}{e\%^2}$$

where n_2 = the least sample size when population is more than 10,000
$p\%$ = population proportion identified
$q\%$ = population proportion not identified
z = z score or the confidence level required
$e\%$ = the margin of error

According to Saunders, Lewis, and Thornhill (2012), where the population proportion identified is not known, it is assumed to be 50%. The study assumed p to be 50%. The confidence level was tested at 95% where 1.96 is taken to be the z value and 5% was taken as the margin of error ($e\%$), which is normally used for research in social sciences. The least size of the sample was n_2, which was determined by using the below formula

$$n_2 = p\% \times q\% \times \frac{z^2}{e\%^2}$$

$$p = 50\% = 0.5,\ q = 0.5,\ z = 1.96,\ e = 0.05$$

$$n_2 = 0.5 \times 0.5 \times \frac{1.96^2}{0.05^2} = 384.16$$

The minimum sample size was taken as 384.
Since the population in the study was less than 10,000, then the adjusted sample size is calculated as follows:

$$n_1 = \frac{n_2}{1+\left(\frac{n_2}{N}\right)}$$

where n_2 = 384 and N = 8605.

$$n_1 = \frac{n_2}{1+\left(\frac{n_2}{N}\right)}$$

$$= \frac{384}{1+\left(\frac{384}{8605}\right)} = \frac{384}{1.04465} = 367.58$$

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The adjusted minimum sample size was taken to be 368.

The collected data were analyzed by use of descriptive and inferential statistic. In analyzing descriptive statistics, the researcher applied frequencies and percentages. Tables were used in the presentation of data. Mean was calculated in computing the measures of central tendency, while standard deviation was calculated in measuring the level of dispersion. For financial performance analysis, this study applied one indicator to measure financial performance, i.e., profitability.

Regression analysis was used to determine the influence of AO on financial performance of SMEs. The researcher applied simple regression model. The model is expressed as

$$Y = \alpha + \beta_1 X_1 + €$$

where

Y = the dependent variable (financial performance)

α = is a constant. This represents dependent variable if there is no independent variable, i.e., the independent variable (X_1 is Zero (0).

β_1 is a constant regression coefficients representing the condition of the independent variables to the dependent variables (or change induced by independent variable (X_1)).

X_1 = accounting outsourcing

€ = error of prediction

4. RESULTS

The researcher formulated the following hypothesis for testing:

$H_{01:}$ AO does not significantly influence financial performance of small and medium enterprises in Thika subcounty.

The specific indicators of AO were professional training, size of the firm, age of the firm, business, and reputation. Financial performance indicator is comprised of profitability. To address this hypothesis, influence of AO was tested on profitability as an indicator of financial performance. Table 1 shows regression results for the influence of AO on financial performance measured by profitability.

The coefficient of determination was 0.965 indicating that 96.5% of variation in financial performance was explained by AO. The remaining 3.5% was explained by factors which were not considered in the study. The model was said to be statistically significant from the results of the *p*-value which was 0.000. It was therefore concluded that AO has a significant influence on financial performance measured by profitability. The null hypothesis was thus rejected with respect to profitability. The model is said to be statistically significant when *p*-value is less than 0.05.

The following equation is a representation of the relationship in Table 1:

$$\text{Financial performance} = 0.192 + 0.958\text{AO}$$

where AO = accounting outsourcing.

This equation indicates that for a change of one unit in AO, there is an increase of 0.958 units of financial performance measured by profitability. This means SMEs should encourage AO as they positively influence financial performance of SMEs by profitability.

5. DISCUSSION

The study revealed that AO has a positive influence on financial performance of SMEs; this may be attributed to the professional skills from the experts. The study established that reputation of the firm providing accounting services as an indicator of AO highly influences the financial performance of SMEs. It was also noted that many respondents indicated that qualifications in accounting practice also highly influence the

Table 1. Influence of Accounting Outsourcing on Financial Performance.

Model Summary				
Model	*R*	*R* square	Adjusted *R* square	Std. error of the estimate
1	0.983[a]	0.965	0.965	0.20393

ANOVA-Analysis of Variance[a]						
Model		Sum of squares	df	Mean square	*F*	Sig.
1	Regression	301.408	1	301.408	7247.594	0.000[b]
	Residual	10.813	260	0.042		
	Total	312.221	261			

Coefficients[a]						
Model		Unstandardized coefficients		Standardized coefficients	*t*	Sig.
		B	Std. error	Beta		
1	(Constant)	0.192	0.046		4.123	0.000
	Accounting outsourcing	0.958	0.011	0.983	85.133	0.000

[a]Dependent variable: financial performance.
[b]Predictors: (constant), accounting outsourcing.

outsourcing of accounting services. This shows that even in outsourcing the SMEs are concerned of the quality of service being offered. This finding concurs with Jayabalan *et al.* (2009) who concluded that outsourcing of accounting functions is an alternative for SMEs so as to sustain a competitive advantage in the business world environment; however, the size of the enterprise and the age of the enterprise as indicators of AO does not highly influence the financial performance of SMEs.

The study also showed that AO has a statistical significance influence on financial performance of SMEs in Thika subcounty. The hypothesis that AO influences financial performance of SMEs in Thika subcounty was therefore confirmed with regard to financial performance measured by profitability. The result indicates that there is need to focus more on outsourcing accounting functions for areas that require expert as this positively influences financial performance. This concurs with Feizpour and Jamali (2009) who concluded that when SMEs want to grow, they should focus on core activities for efficiency matters and outsource to compensate for resource (competencies) gaps (Mirbargkar, 2009).

6. CONCLUSIONS

The study has shown that AO has a positive influence on financial performance of SMEs. The study concludes that influences of AO enhance relevancy, reliability, and improvement in financial performance of small and medium enterprises. The study also established that the size of the enterprise as an indicator of AO does not influence financial performance of the SMEs.

7. RECOMMENDATIONS

The study found that SMEs financial performance is positively influenced by AO. Based on this finding, the study recommends that managers and owners of SMEs should endeavour in seeking more service from qualified accountants as this may increase the quality of financial records and improve their SMEs financial performance.

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