

Assessment of Small and Medium Enterprises Alignment of Investment Decisions to overall Business Strategy in Mombasa County, Kenya.

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ABSTRACT

The background problem is that the precise handlings of a firm's resources are critical for the firm's endurance. Companies usually have official procedures for calculations of their profitability of investment projects. On one hand is the corporate strategy which directs the company's activities, determines how company resources should be used. The corporate strategy and the financial calculations should work together to ensure the best and most efficient allocation of the resources of the company. Regrettably, it does not happen like this all the time or most of the time. Therefore, the purpose of this study is the analysis of SME's, alignment of investment decisions to overall business strategy to enhance performance. The objectives of the research are to determine the extent of SME's alignment of investment decision to overall business strategy to enhance performance. Therefore, it will be established the nature of SME's investment decisions practices. In addition, there will be the establishment of the business strategy adopted by different SME's. What is more, the establishment of the challenges faced by the SME's in the alignment of their investment decisions to overall business strategy. And in addition to come up with recommendations on how SME's can address the challenges faced when aligning investment decisions to overall business strategy. The study will thus focus on divisionalized companies, where it is to be expected that investments and strategy are not planned by the same people but by employees in different departments. The literature reviews on alignment of investment decision and strategy which has been drawn from different authors. It will contain two parts: the theoretical review and the empirical review. Significant issues related to the research topic and finally the research gap filled by the research embarked on. The methods that will be embarked on are Phenomenological research, the goal being to qualitatively describe a lived experience of the phenomenon; it will draw attention to the research design; in order to avoid bias and human error a mix of naturalistic observation and interview as well as surveys will be made use of in the research design. Data will thus be collected quantitatively and qualitatively, and the targeted populations are that of entrepreneurs with more than one investment in Majengo and central business district. The raw data once collected will be analyzed and represented by using tables and graphs and the data analysis tools that will be used are ANOVA, SPSS, t-test and frequency to eliminate human error and come up with usable data for the research.

Keywords: Small and Medium Enterprises, Investment Decisions, Business Strategy.

1. INTRODUCTION

History indicates that most new business failures occur within the first five years of their life, if and when large percentage of Small Medium Enterprises (SMEs) survive and grow to large firms this would have a very positive

impact of the economy of that country and eventually the world economy as well (Tambunan, 2006). Wide variations definitions regarding size of a small company in some literature size of small economy is defined only by number of employees and annual turnover. Therefore the role SMEs play in our society is unquestionably very important for example in Portugal around 98% of the industrial fabric is composed by SMEs in the United States it's about 50% of the nation's gross domestic product and in European Union around 99.8% firms are being off the record as small businesses(Matlay, 2004). Into the bargain SMEs play a significant role in Malaysian Country's trade and industry development. According to statistics provided by SMIDEC (2004); Malaysian SMEs are defined according to size, turnover and activity. Therefore, SMEs accounted for 89.3 per cent for all their establishments in the sector for manufacturing in 2000 and contributed 32.5 per cent of employment in 2003 and what is more, the significance addition in production from SME is expected to be in the worth of RM120 billion or 50 per cent of total produced in the sector for manufacturing by the year 2020 (Kauffmann, 2005).

Therefore since Malaysia is a developing country and in Asia. Thus it is safe to say that the development of private segment contrasts greatly throughout Africa. Some SMEs are prosperous like in South Africa, Mauritius and North Africa due to their contemporary financial system and clear government policies. However in other areas SMEs are slowed down by political instability or lack of transparency and corruption (Kauffmann, 2005). The number of SMEs growing in Nairobi as evidenced by the growing activities within the business environment which is highly chaotic, due to this chaotic small businesses are affected more than large companies because the response to environment changes is different in small business than in large companies; they may exit from one business area and have resources and strategic choices not available to small business enterprises.

The precise handling of a firm's resources is critical for the firm's endurance. Companies usually have official procedures for calculations of their profitability of investment projects. On one hand is the corporate strategy which directs the company's activities, determines how company resources should be used. The corporate strategy and the financial calculations should work together to ensure the best and most efficient allocation of the resources of the company: Capital allocation is one of the emerging key competitive lead and thus it should be carefully allied with a company's strategy. Corporations thus can no more compete only along innovation scope (Vause, 2005). Thus the big question is why is the design of capital budgeting integration into strategy a problem? Capital budgeting is an often a bottom-up process, with investment suggestions coming e.g. from factory/plant or product lines. Thus strategic planning, on the other hand, is a top-down process (Shim, Siegel, & Shim, 2011) Finance deals with the field of capital budgeting while strategy personnel deal with the organizations strategy, therefore contact and information flow between different departments so as to align with the organizations strategy can be very difficult to achieve especially when different departments have different set of goals of their own to achieve, therefore everyone will opt for what give them an edge at the end of the day(Dayanand, Richard, & John, 2002).

SMEs are leading type of firms and they are important to industrial economies and they live and die quickly. Small and Medium Enterprises performance is very essential for development of the economy of any country. Small and Medium Enterprises represent the seed for future large companies and corporations. When we look at SMEs globally and their success, just in Portugal around 98% of the industrial fabric is composed by SMEs in the United States it's about 50% of the nation's gross domestic product and in European Union around 99.8% firms are being off the record as small businesses (Matlay, 2004) thus proving that SMEs in developed nations are the one of the major contributors to the development of their nations and economy as well.

Failure rate among small businesses in Mombasa County is thus high when compared to other developed nations even though they are increasing in numbers year by year; thus leading to misalignment of investment decisions to overall business strategy. Sequentially to get to the bottom of the problem above and avoid financial losses, it is very important to thoroughly depict what these negotiations consist of and preserved in the company structure. This study therefore seeks to fill the gap, by conducting research on SMEs alignment of investment decision to overall business strategy in Mombasa county Kenya.

2. SUPERIOR INVESTMENT DECISION RULE

According to top researchers firms have to decide whether to invest or not, when faced with new projects and investments (Gunasekaran, Love, F.Rahimi, & Miele, 2001). Investment decision rules allows for the formalization of the process and specify what conditions need to be met for any projects to be accepted by looking at different investment decision rules (Berk & DeMarzo, 2010). At the outset, in order to maintain fair

study by project managers so as to be bring in his or her prejudiced assessment into the decision making process so as to ensure that different projects are judged without fail. Consequently, investment decision rule that is too automatic or rules are bended for biasness then it is not a good rule, what is more it should be able to maximize the value of the firm. Projects that are suitable using this rule ought to boost the value of the firm accommodating them. And for projects that do not meet the requirements, it would obliterate the value, if the firm had invested in that project. To conclude, it should work across a mixture of investments (Steven G. , 2008).

Even though we can use a number of different investment decision methods to analyze projects and investments, however one rule has to govern all the rest. In other words, when the investment decision rule leads to different conclusions on whether the project or investment should be rejected or accepted, one decision rule has to be the tie-breaker and thus it will be the primary rule in every decision making difficulty.

2.1 Steps of Investment decision rules

For a given decision rule, the efficient set is unique for all investors who obey the basic assumptions which underlie this rule, since in practice it is applied to objective data (e.g. rate of return on securities). According to an article "Making Investment Decisions with the Net Present Value Rule" (Steven R. , 2008), Corporation determine the Net Present Value (NPV), means forecasting the cash flow of a project and discounting them by a discount rate which cover opportunity costs of capital. If positive NPV is show on the results, it means that the venture will create wealth.

If there is a well-functioning market, one significant feature is that the NPV will only lead to the right decision. Every cash flow anticipated is unique and is project dependent to help the manager to do an investment decision. While the philosophy of applying the NPV rule is same internationally, but there may be different assumptions and inputs from nation to nation. Consequently, customary NPV analysis is more than appropriate for projects with very miniature to no uncertainty (Steven R. , 2008).

2.2 Methods of Investment decision rules

According to Berk and DeMarzo (2010), there are two methods to estimate returns of investment. Each method has two types of investment decision rules. The investment decision rule are divided into two as well the traditional method which is divided into two as well the Average Rate of Return (ARR) and the payback rule and the Discounted Cash Flow Technique which is further separated in two the Net Present Value (NPV) and Internal Rate of Return(IRR).

Average Rate of Return (ARR)

The average rate of return guarantees the return averages out to the average rate of return.

Formula:

$ARR = \text{Average Net Income from project} / \text{Average book value of investment project}$

This is also formulated as:

$= \text{Average Net Income over of project} / \{ \text{Beginning book value} + \text{Ending book vale} / 2 \}$

The rule being:

If ARR is higher than the target set by the firm, then the project should be accepted.

If ARR is lower than the target set by the firm, then the project should be rejected.

Therefore the advantages of ARR is that is easy to calculate and information needed is easy to obtain. However, the disadvantage is that it ignores the time value of money; it judges the arbitrary choice of target ARR and it uses accounting information not cash flow and market values.

Payback Period Rule

The payback period is the amount of time it takes to recover or payback the initial investment. A prospect that pays back the primary investment quickly is the most excellent idea.

The Formula:

$\text{Payback period} = \text{Initial Investment for the project} / \text{Net Annual cash flow.}$

The Rule is that:

If the payback period is less than some pre-specified cut off then accept the project.

If the payback period is more than some pre-specified cut off the reject the project.

The advantage of using this rule is that it is simple rule; it focuses on liquidity of an investment project, what is more it adjusts to the uncertainty of late-arriving cash flows. Therefore, it is thus supportive for small businesses that care about their liquidity positions when deciding on small projects. However the drawbacks are that it also ignores time value of money, the cash flow arriving after the payback period.

Discounted cash flow technique

Net Present Value (NPV) Rule

Net Present Value is the difference between the present value of the future cash flow from an investment and the amount of investment. Thus the present value of the expected cash flow is computed by discounting them at the required rate of return. The difference lies in the discounting of the cash flows with the discounted payback period, while the cash flows are not discounted in the traditional payback period.

Formula:

$$NPV(i, N) = \sum_{t=0}^N \frac{R_t}{(1+i)^t}$$

The rule is that:

If NPV is greater than 0, accept the project.

However if the NPV is less than 0, reject the project.

Therefore the advantage is that it counts for the time value of money, it provides a gauge of the change in company value by accepting the project.

Internal Rate of Return

The IRR investment is used in capital budgeting to measure and compare the profitability of investments; therefore IRR is the interest rate that makes the Net present value zero.

Formula:

$$0 = P_0 + P_1/(1+IRR) + P_2/(1+IRR)_2 + P_3/(1+IRR)_3 + \dots + P_n/(1+IRR)_n$$

Where P_0, P_1, \dots, P_n equals the cash flows in periods 1, 2, n, respectively; and IRR equals the project's internal rate of return. However in a one-period project scenario the formula is rate of return is equal to $(\text{payoff}/\text{investment})-1$, $NPV = \text{payoff}/(1+\text{discount rate}) - \text{investment}$. Then if NPV is equal to 0, then discount rate is $(\text{payoff}/\text{investment}) - 1$.

The rule is that:

If the IRR is greater than the investing cost then it creates value for the firm.

If the IRR is less than the investing cost then that investment opportunity will not be taken.

The advantage is that it takes into account the time value of money; it is closely related to NPV, thus leading to same decision. However the shortcoming is that it presumes that arriving cash flows are at IRR.

2.3 Empirical review

In some if not all organizations in Kenya or to be more specific in Mombasa they do not have all their eggs in one basket thus they are diversified and for them to do that efficiently and effectively they need to plan their firms' strategies with their capital budgeting so as not to waste resource and so as to gain from their investments. Therefore firms or organizations should not assume that this kind of thinking is just for major organizations but as of the case above where by small firms embark on different ventures and the resource available to them are limited and hard to get they need to take advantage of this kind of strategizing and thinking of aligning capital budgets and corporate or firm strategy.

What is more, most of the researchers find that lack of credit or competition (Survey, 1999) as the most pressing factors to SMEs operations or business closure, and other researchers look at management strategies that affect the performance. In addition past researchers have been looking at failure and success of SMEs none have gone into depth on the issue of alignment of strategy and budget to achieved enhanced performance. Therefore, they do not take in to account that the business can find its solutions within its business structure first and foremost before looking at the constraints that affect the business thus its more advisable to look at solutions instead of going over and over the constraints.

According to Michael Bowen and associates in their article, they suggest that SMEs play very important role in the Kenyan economy however 3/5 fail within a short period of operation even though they contribute to 50% of new jobs that a created in the process (Bowen, Morara, & Mureithi, 2009). What is more; factors like lack of credit or competition as most pressing factors to SMEs operations and thus contributing to enormous number of business failures in the process (Survey, 1999). In another investigation by Njanja she looked at management strategies that affect the performance of SMEs in Kenya (Njanja, 2009). Also most of the studies are concentrated in the west and the models used have not been tested in Kenya. This means that Kenyan small business owners cannot dependably make use of those models to predict their business performance. Therefore by constantly aligning the investment decisions and overall business strategy it will lead to enhanced business performance.

2.4 Gap analysis

According to Boquist (Boquist, 1998), misconfiguration between strategy and capital budgeting is a widespread drawback of the capital budgeting scheme. In the worst scenarios the capital budgeting and the strategy will contradict. As in case the strategy could be global expansion to outside markets to increase profitability and sustainability however a capital budgeting criteria might single out against projects which have payback periods of three years and more. So why the negation and where does it arise from? Therefore, as firms grow their strategy formulation moves away from capital budgeting and different department become separated further instead of them getting integrated, thus leading to autonomous business units as the top management formulate the plans without consultation with the bottom management / employees if the budget available will be viable to achieve the strategy. The distance that keeps widening will lead to capital budgeting and corporate strategy losing touch and togetherness as one to achieve firms' objective.

3. RESEARCH METHODOLOGY

3.1 Research design

The research used the descriptive type of research design by observing naturalistically and making sure not to interfere with the behavior under observation. This choice was made due to the fact that it is not possible to test and measure the large number of samples for our quantitative experiment. Descriptive research engages gathering of data that depict proceedings and then arranges, charts, portrays, and describes the data collection (Glass & & Hopkins, 1984). It makes use of visual aids like graphs and charts to help the reader in understanding the data division. Since the human beings mind cannot remove the complete significance of a large mass of raw data, descriptive data are very important in reducing the data to controllable form. What is more, interviews will be used and surveys give.

3.2 Sample size and sampling techniques

Multi-stage random sampling approach will be used to obtain the preferred sample as follows: random sampling will be used to select fifty seven businesses from each of the areas of central business district and Majengo giving a total of one hundred and fourteen (114) businesses.

Therefore: leading to, the use of simple random sampling and to obtain sample of two (2) ventures from the one hundred and fourteen (114) businesses each of them giving a total of two hundred and twenty eight (228) ventures in both the areas combined.

Regions	No. of Business observed	No. of Investment Ventures
Central Business District	57	114
Majengo	57	114
TOTAL	114	228

Table 1: Source: Researcher's Table (2013)

3.3 Data collection method and procedure

There are different ways of collecting data depending on cost, time and other resources available to the researcher. Data can be collected quantitatively through observation through experimentation or survey. Our survey or questionnaire will be conducted in different ways as people in this field are always busy and might not have the time to set up meetings and sit-downs all the time. These are some of the methods that will be used: Personal interview whenever possible – face to face, Telephone interviews or E-mail them the survey as well as observation. If the data collection procedure is planned properly then the data collected will be more accurate and dependable. Our survey is conducted by structured questionnaires and interviews. Almost certainly the least taxing method is the personal, face-to-face interview as it requires the interviewee to speak the matching language in which the questions are inquired, and thus has basic verbal and listening skills. There is no reading skills required in this case and a friendly, motivating interviewer can increase response and uphold motivation with longer questionnaires, explore for responses, shed light on uncertain questions, use memory jogging techniques for aiding recall of events and behavior, and control the order of the questions.

3.4 Data analysis and presentation

The raw data collected was in usable categories, therefore input/ data entry was cross checked at three levels to avoid human error and for quantitative data to make use of the software SPSS. This software helped in making different statistical hypothesis tests like t-test, frequency and ANOVA. In addition for presentation visual aids like graphs and charts helped the reader in understanding the data division. Since the human beings mind cannot remove the complete significance of a large mass of raw data, descriptive data are very important in reducing the data to controllable form. However for qualitative it will be content analysis to analyse our statistics.

4. FINDINGS

The researcher was determining the extent of Small and Medium Enterprises alignment of investment decisions to overall business strategy to enhance performance in Mombasa County, Kenya. According to the research, majority of the respondents were male and they had at least a college certificate. This indicates that the researcher used a relevant sample because they had knowledge and of more than 1 year. This has a sign that the research could represent a true view of the matter. The respondents collectively agreed that they had faced business failure due to misalignment of capital and business strategy and that during recession periods they were affected severely. They also depended on borrowing for new investment, what is more due to the nature of business environments volatility they have to conduct internal and external survey before they embark on any investments. In addition their willingness to take financial risk is that of average risk taker and that they are very uneasy to adapt when things go wrong financially.

According to the research when the extent of their investment decisions to overall business strategy, it was found that to the firms the capital budgeting is more important than their corporate strategy in their firms thus leading to misalignment of investment decisions to overall business strategy. The researcher also found that they agreed that business strategy is constrained by the capital budget in the planning by the organization also taking into account external constraints. According to the research it was found out that issues that contributed to misalignment of investment decisions and to what extent; it was found that contingency planning existed for alternative course of action but in paper work only it was never made use of, in addition planning was solely done by high level management in the investment, even though planning happens in different ways and at all levels in the end planning is in the hands of high level management only. Also most of the small and medium enterprises applied industry experience rather than managerial experience however the firms stored facts and information for future investment references.

What is more according to the research the respondents agreed, that according to the challenges that they face in the alignment of their investment decisions to overall business strategy that business strategy and investment strategy are equally important to do business, and also that major cause of misalignment of investment decisions in their firms was lack of functional / operational knowledge among others like lack in integration of different departments, departmental behavior and others. However they disagreed with the statements that good understanding of investment and capital budgeting, the existence of sharing of information and transparency and that business strategy and investment strategy are aligned in their firms.

5. CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

The objectives of the research are to determine the extent of SME's alignment of investment decision to overall business strategy to enhance performance. According to the research the alignment of investment decisions to the overall business strategy is therefore very important so as to enhance the firm's performance. Therefore, capital budgeting and investment decisions should be well aligned; this will assist in enhanced performance of the firm, which can be achieved by looking at the nature of Small and Medium enterprises and extent of Small and Medium Enterprises alignment to overall business strategy.

5.2 Recommendations

The study recommendations draw from the findings of the study that most of the statements to address the challenges faced when aligning decisions to overall business strategy were agreed with by the respondents. Therefore there should be good relations within all the departments, corrective action is taken when capital budgeting and investment decisions are not aligned and being met equally, correctly deploying financial assets and human resource, good interpersonal skills and making use of niche strategy all these will help in a successful alignment of investment decisions to overall business strategy. The research also recommends that a further research on the alignment of investment decisions to the strategy implementation and organizations goals and mission.

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