



## MANAGEMENT OF BUSINESS CHALLENGES AMONG SMALL AND MICRO ENTERPRISES IN NAIROBI-KENYA

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### Abstract

Small and Micro Enterprises (SMEs) play an important economic role in many countries. In Kenya, for example the SME sector contributed over 50percent of new jobs created in 2005 but despite their significance, SMEs are faced with the threat of failure with past statistics indicating that three out five fail within the first few months. This study sought to understand how SMEs manage the challenges they face. These challenges seem to change (evolve) according to different macro and micro conditions. This study employed stratified random sampling to collect data from 198 businesses using interviews and questionnaires. The data was analysed descriptively and presented through figures, tables and percentages. The findings indicate that SMEs face the following challenges; competition among themselves and from large firms, lack of access to credit, cheap imports, insecurity and debt collection. Credit constraint seems to be easing up when compared to previous researches. Relevant training or education is positively related to business success. The SMEs have the following strategies to overcome the challenges; fair pricing, discounts and special offers, offering a variety of services and products, superior customer service and continuously improving quality of service delivery. The research concludes that business success is a consequence of embracing a mix of strategies.

### Keywords:

challenges, evolution, urban, small and micro-enterprises (SMEs)

### INTRODUCTION AND BACKGROUND

The small and micro enterprises (SMEs) play an important role in the Kenyan Economy. According to the Economic Survey (2006), the sector contributed over 50 percent of new jobs created in the year 2005. Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007). According to Amyx (2005), one of the most significant challenges is the negative perception towards SMEs. Potential clients perceive small businesses as lacking the ability to provide quality services and are unable to satisfy more than one critical project simultaneously. Often larger companies are selected and given business for their clout in the industry and name recognition alone.

Starting and operating a small business includes a possibility of success as well as failure. Because of their small size, a simple management mistake is likely to lead to sure death of a small enterprise hence no opportunity to learn from its past mistakes. Lack of planning, improper financing and poor management have been posited as the main causes

of failure of small enterprises (Longenecker, et al., 2006). Lack of credit has also been identified as one of the most serious constraints facing SMEs and hindering their development (Oketch, 2000; Tomecko & Dondo, 1992; Kiiru, 1991).

Education is one of the factors that impact positively on growth of firms (King and McGrath, 2002). Those entrepreneurs with larger stocks of human capital, in terms of education and (or) vocational training, are better placed to adapt their enterprises to constantly changing business environments (King and McGrath, 1998). Infrastructure as it relates to provision of access roads, adequate power, water, sewerage and telecommunication has been a major constraint in the development of SMEs (Bokea, Dondo & Mutiso, 1999).

As with many developing countries, there is limited research and scholarly studies about the SME sector in Kenya. The 1999 National Baseline Survey conducted by Central Bureau of Statistics, ICEG and K-Rep Holdings provides the most recent comprehensive picture of SMEs in Kenya. Mead (1998) observes that the health of the economy as a whole has a strong relationship with the health and nature of micro and small enterprise sector. When the state of the macro economy is less favourable, by contrast, the opportunities for profitable employment expansion in SMEs are limited. This is true especially for those SMEs that have linkages to larger enterprises and the economy at large. Given this scenario, an understanding of the dynamics of SMEs is necessary not only for the development of support programmes for SMEs, but also for the growth of the economy as a whole. Given the importance of small businesses to the Kenyan economy and the exposure to risks owing to their location, there was need to conduct an empirical enquiry to investigate the challenges SMEs in Nairobi face and how they manage those challenges. The study targeted those enterprises within the Central Business District in Nairobi City.

### **Research Questions**

1. What are the business challenges facing small and micro-enterprises operating within Nairobi City?
2. What strategies are employed by small and micro-enterprises in countering the challenges that they face?
3. What guiding principles can help small and micro enterprises to improve their performance?

### **Sampling**

The research used a descriptive research design. The research employed stratified random sampling in selecting respondents. The population was segregated into several mutually exclusive subpopulations or strata herein referred to as business categories as shown in Table 1 (see appendix).

The research applied proportionate stratification that is based on the stratum's share of the total population to come up with the sample in each stratum. The actual businesses interviewed were arrived at by using simple random procedures to draw the sample from each stratum. A total of 200 interviews with business owners and managers, distributed proportionately were carried out for this survey. With a target of 200 interviews, 250 contacts were made yielding 198 interviews. This represents a response rate of 79.2 percent. Out of 198 respondents, 64.6 percent were owner managers and the remaining

35.4 percent were senior managers (employees) with decision making authority. The respondents were composed of 55.1 percent females and 44.9 percent males.

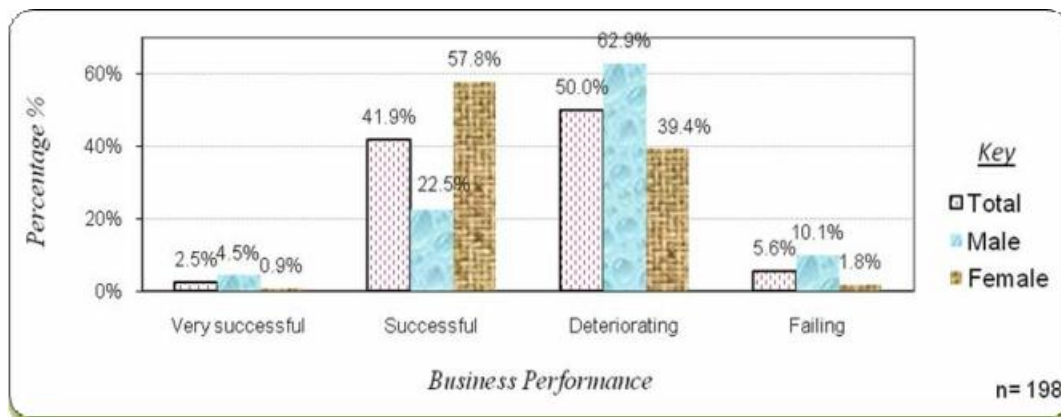
**DATA COLLECTION AND ANALYSIS**

A questionnaire was used to collect primary data by way of interviews. The respondents were business owners or those involved in the start-up and day to day running of these businesses. The data gathered was analysed and presented using descriptive statistics. Primary data was captured using Census and Survey Processing System (CSPRO) package and processed using Statistical Package for Social Sciences (SPSS) for windows and Microsoft Excel.

**Results**

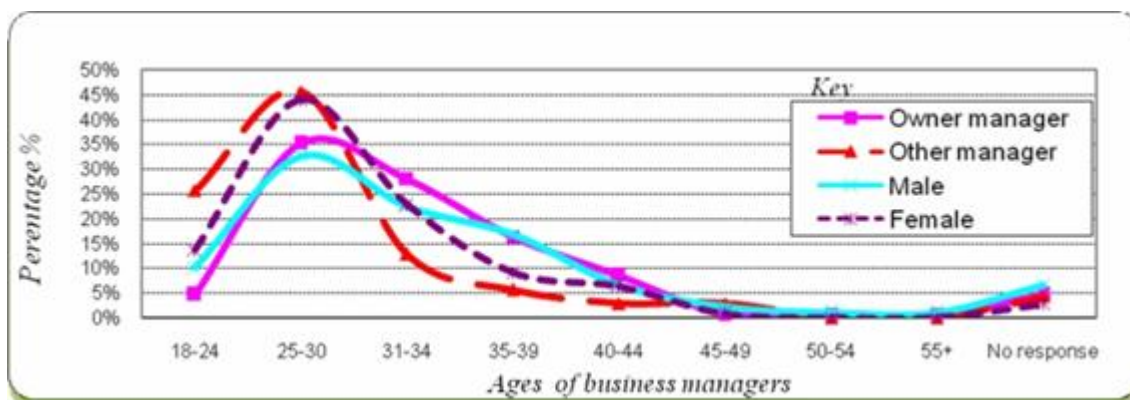
Up to 50 percent of the respondents in this study considered their businesses performance to be deteriorating while 41.9 percent considered their business successful with only 2.5 percent respondents saying their businesses were very successful (see Figure 1).

**FIGURE 1: Rating of Business Performance**



Majority of the managers and business owners fell within 25-34 year age bracket. Clearly, most micro and small enterprises are owned and mainly run by people in their late 20s and early 30s as shown in Figure 2 below).

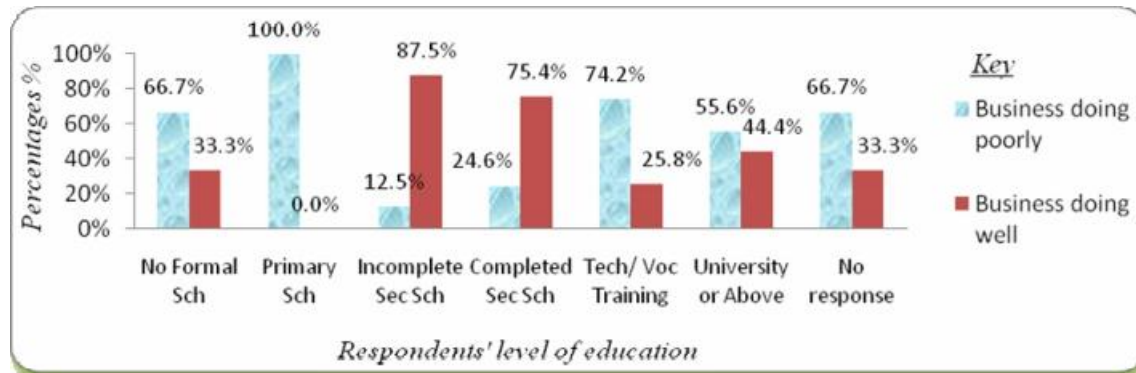
**FIGURE 2: Age distribution by business position**



**Level of Education and Business Performance.** Majority of the respondents (47 percent) had post secondary school or vocational training followed by those who had completed secondary school (28.8 percent). Compared to owner managers, more employee managers

(65.7 percent) had higher qualifications in post secondary school or vocational training compared to owner managers (36.7 percent). Only a small proportion of the respondents (4.5 percent), had reached university level or above (see Figure 3). It can be inferred that small and micro businesses are dominated by people with relatively low levels of education.

**FIGURE 3: Relationship between performance and level of education**



Analysis to determine if there was a relationship between business performance and level of education did not provide conclusive results. Overall, more (75.4 percent) of those respondents who had received technical or vocational training said their business performance was deteriorating. This may imply that that formal education is not a critical factor in business success (See Figure 3 above). 51 percent of the respondents said they had received some specific training in the area of their business as compared to 49 percent who had not received business specific training.

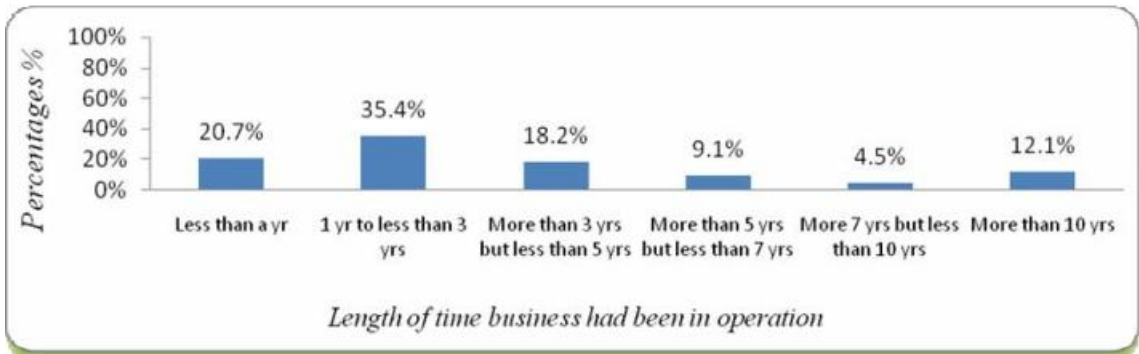
The study sought to determine if there is a relationship between business performance and level of training in the line of business. The results show that 49.5 percent of those who had received training in their areas of business reported that their businesses were doing well. Given that 51 percent received training and nearly all of them (49.5 percent) said their businesses were doing well, one may conclude that relevant training can produce positive results in the running of businesses (See Figure 4). The figure below also shows that 60.8 percent of those not trained reported that their businesses were doing poorly as compared to 39.2 percent who reported that their businesses were doing well without training. It can be inferred that there is a negative relationship between lack of training and business performance.

**FIGURE 4: Training versus business performance**



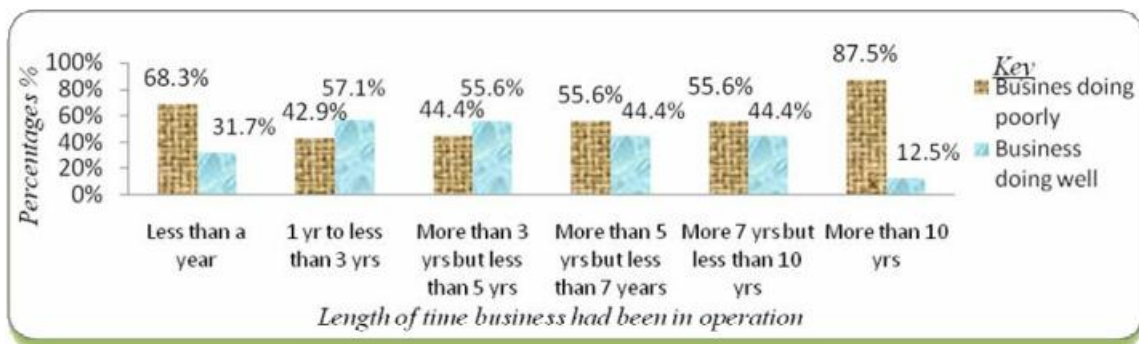
**Duration of time business has been in operation.** 35.4 percent of the respondents said they had operated their businesses for a period between one and three years and 20.7 percent of the respondents had only operated for less than a year. Between 3 and 10 years constituted 31.8 percent of the sample, while those who had been in operation for more than 10 years were only 12.1 percent of the sample (See Figure 5). The data shows that most of the businesses (56.1 percent) in existence were less than three years old.

**FIGURE 5: Length of time business has been in operation**



68.3 percent of businesses that had been in operation for a shorter period (less than one year) reported that their business performances were on the decline (Figure 6). Clearly, businesses that are starting seem to face serious challenges that make the owners consider their businesses as doing poorly within the first year of start up. This finding is clearly supported by the literature. It also seems that most micro and small businesses hit their peak at the fifth year. After the fifth year, most entrepreneurs seem to suffer from what may be described as entrepreneurial burnout and the excitement declines. This may partly explain why most businesses that are more than 5 years and above consider their businesses as being in the process of failing. This finding seems to confirm the observation made by Longenecker et al., (2006) that entrepreneurial burnout may lead to entrepreneurs losing interest in one business venture and instead look out for other opportunities.

**FIGURE 6: Business performance versus length of business operation**



Starting a business just because one wants to make money can almost spell doom for the business. Cross tabulations revealed that 57.1 percent of those who started their businesses in order to make money consider themselves to be doing badly while a majority of those who wanted independence (69.6 percent) consider themselves to be doing well as indicated in Table 2 (See appendix).

**Source of markets and customers.** 90.9 percent of respondents reported that their customers came mainly from Nairobi while 7.1 percent mentioned areas outside Nairobi. Clearly most enterprises have their markets within their locality. This may pose a challenge given that they have to compete for the same market with enterprises from other nations and regions given the reality of globalisation. It is important that businesses look beyond their local catchment area (Ronge et al., 2002). Globalisation presents both challenges and opportunities. As much as SMEs remain local, they need to consider markets beyond their national and regional boundaries.

### **Main Challenges facing Small Businesses**

On the main challenges businesses face, competition, insecurity, debt collection, lack of working capital and power interruptions were reported as the top five challenges facing micro and small businesses. 89.4 percent of respondents mentioned competition while 68.2 percent mentioned insecurity as a challenge. 54.5 percent, 53 percent and 44.9 percent of the respondents mentioned debt collection, lack of working capital and power outages respectively. Political uncertainty cost of materials, hawkers, low demand and restrictive by-laws completed the list of ten main challenges facing these businesses. Table 3 (See appendix) shows a summary of the most pressing challenges mentioned by respondents.

Not every business reported that they were experiencing business challenges. Out of the 198 businesses that participated in the survey, 177 (89 percent) reported various business challenges. Competition was ranked as the most pressing (38 percent) followed by insecurity and lack of credit with 18 percent and 7 percent of the respondents respectively. However, it is important to note that whereas competition was acknowledged by majority of respondents (see Table 4 in appendix), only 38 percent of respondents ranked it as a number one challenge. This implies that competition is not the same across the business sectors. It is also possible that entrepreneurs have accepted competition as a way of doing business since the market is liberalised. Further analysis through cross-tabulations revealed that competition is highest in the service sectors, mainly businesses falling in code 115, (See Table 1 in appendix).

### **Managing Business Challenges**

When asked how they handle the challenges faced, most respondents reported that different challenges called for different approaches. Below are some of the responses adopted to counter various challenges.

**Competition.** Out of the 177 respondents who mentioned competition as a challenge, 71 percent mentioned it among their top three. When asked how they counter their competitors, 30.2 percent of the respondents mentioned good customer service followed by discount offers (which vary according to client), which was mentioned by 18.3 percent as the remedy. 7.9 percent of the respondents reported that they use price as a competitive edge by selling more cheaply than their competitors. Selling a variety of products was mentioned by only 6.3 percent of the respondents. Offering credit facilities, selling of quality goods and services and offering customers additional services like free training were mentioned by 5.6 percent, 4 percent and 3.2 percent of the respondents respectively (See Table 5 in appendix). Using price to compete may mean lower profits, even if it may translate into higher volumes. However, this strategy can be employed by everybody hence spelling a death knell for the business given the fierce competition in the small business sector.

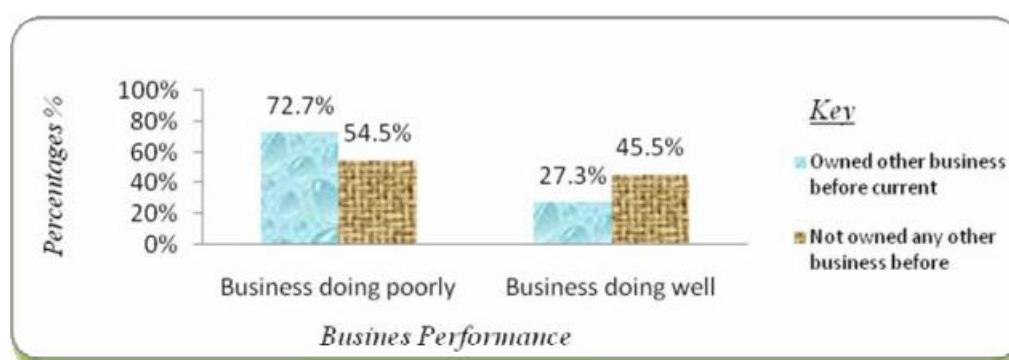
**Poor security.** Security threats pose a great challenge to businesses and many business owners and managers employ various means to help prevent or deter would-be criminals. 36 percent of respondents ranked poor security among the top three challenges their businesses face. Out of these, 37.5 percent make use of security firms or guards to safeguard their businesses. Approximately 22.2 percent of them close early to avoid thugs while 6.9 percent opt to carry their stocks home while some sleep in their business premises as a security measure. This implies higher cost of doing business as they respond to the security challenges.

**Debt collection.** 25 percent of respondents ranked debt collection among the top three challenges they face in their businesses. As a response to this challenge, half of those who face this problem resort to collect their debts at the end of the month, 20 percent reported that they avoid giving goods and services on credit and 10 percent of them demand down payments before giving a service. Other businesses reported that they have loyal customers (2 percent) whom they consider reliable while a few (2 percent) said they encourage their customers to pay in instalments so as to reduce the payment load.

**Hawkers.** 10 percent of the respondents cited hawkers as a challenge to their businesses. As a response to this challenge, 15 percent of the businesses that face this problem reported that they sell cheaper than the hawkers while another 15 percent said they sell goods of a higher quality. Competing with hawkers on price is debatable since hawkers are known to sell cheaply. Nevertheless, respondents mentioned they use competitive pricing strategy to counter the hawkers. There is also a sense of security experienced by customers when they deal with a trader who has a physical location. Selling of a variety of goods was also said to be a strategy employed by small businesses (15 percent) to counter the challenge posed by hawkers.

**Past Experience.** On the question of whether they had ever started or owned other businesses that were no longer in operation, only 6 percent of the respondents responded in the affirmative. However, 90 percent have since closed owing to various reasons.

**FIGURE 7: Relationship between performance and previous experience**



Further analysis shows that previous ownership of similar businesses does not guarantee success in future business. Figure 7 shows that 72.7 percent of those who had owned similar businesses in the past still considered their current businesses as being in the process of failing. Considering this finding, one may infer that future business success is not pegged on previous ownership of similar businesses.

### **Business Success Factors**

The research categorised businesses that rated themselves as either very successful, successful and slightly successful as successful businesses. These businesses were then asked to give reasons that had contributed to their favourable rating of their businesses. Out of this, 54.5 percent of them reported discipline in finance management followed by availability of customers (53.4 percent) as well as physical location of the business (42 percent) as the main reasons why their businesses have performed well. Skilled workforce was mentioned by 38.6 percent of the respondents.

The other factors reported include business networking, competitive pricing or low cost, selling variety of products and services and availability of capital as well as credit from the banks as some of the key reasons (see Table 6 in appendix). The results on the table reveal that there is no magic bullet and that all factors mentioned above are important in contributing to good performance of businesses.

As much as Kenyan SMEs may cite lack of credit or competition as the most pressing factors to business operations and contributing to a huge number of business closures (National Baseline Survey, 1999) these factors can be considered secondary rather than primary problem. This survey shows that the solutions lie within the business structures. Disciplined finance management, differentiating products and services to satisfy customer needs, having your business located within the reach of your customers and good networking can make a difference between succeeding and failing.

### **Professional Membership**

Belonging to a professional body helps gain a competitive advantage in a business. Being a member of an industry association implies that one is serious about the business they do. This could also help in networking and obtaining of business information. When asked if they belong to any professional society, only 14 percent of the respondents answered in the affirmative. 18 percent of those who are members of professional associations belonged to the Marketing Society of Kenya (MSK), 14 percent belong to Kenya Women Finance Trust and 11 percent belong to Nairobi Central Business District Association (NCBDA) while 7 percent belong to Kenya Association of Manufacturers (KAM) among others.

### **DISCUSSION**

89 percent of businesses that participated in this research are faced with various challenges, which if not managed well can lead to business failure. It is the researchers' view that the seeds of future business performance are sown in the early stages of the business life and that understanding them has a predictive value. It is also clear that infant businesses need as much support and help in their early years when their motivation is high as well as in their maturity phases when their levels of innovations are low.

Competition, insecurity, debt collection, lack of working capital and power interruptions were the top five cited challenges facing businesses in Nairobi. While the challenges facing small businesses do not include capacity concerns such as input availability or labour costs, frequent mention of political uncertainty, unfavourable laws, in addition to high taxes indicates that government and its regulations are a major obstacle to SMEs operations. The government has also failed to maintain law and order with 68.2 percent of the respondents reporting insecurity among top five challenges.



Existing literature on SMEs indicate that lack of capital is a strong constraint to growth (National Baseline Surveys, 1993; 1995; 1999; Stone, Levy and Paredes, 1992). According to these studies, most SMEs rely mainly on own savings and reinvested profits to finance their business. Comparison of results of the three baseline studies of 1993, 1995 and 1999 show minor improvements in the situation-from 9 percent of SMEs accessing credit in 1993 to 10.8 percent in 1999. This research suggests that availability of credit is no longer as bad as it used to be judging from the previous findings on credit and small scale businesses.

Different SMEs meet the above mentioned challenges in different ways. Strategies used included fair pricing, discounts and special offers, offering a variety of services and products, superior customer service and continuously improving quality of service delivery. Clearly there is no magic bullet in achieving success. Business success is a consequence of embracing the whole package of strategies in order to succeed. Selling a variety of products or offering a variety of services is just as important as embracing prudent financial management systems.

Most of businesses sampled in this survey were less than three years old. Considering that a simple random approach was used in the selection, the results of this research suggest a high failure rate. Looking at the performance rating by length of time the businesses had been in operation; one may conclude that as businesses mature their returns seem to decline. This may signal a lack of innovation on their part. Lack of innovation and search for changing customer needs reduces the survival of businesses. It is therefore imperative that businesses proactively innovate to meet customer demands. Alternatively, this result may be interpreted using the product life cycle. This could be especially true if the business deals only with one product. As the product reaches the decline stage, the business may decline and the business is likely to fail.

The research also indicates that 90.9 percent of SMEs interviewed serve the customers who live and work in the same town or city. With globalisation, businesses need to look beyond their local catchment areas (Ronge et al., 2003). Globalisation is a reality and a challenge that small businesses have to contend with. Globalisation presents both challenges and opportunities. As much as SMEs remain local, they need to think global and target markets beyond their regional boundaries.

The citing of competition as a top challenge is expected as most SMEs, especially small sellers and producers tend to congregate in dense markets and overcrowded cities (National Baseline Survey, 1999). It also suggests a lack of market information and innovation as most new businesses are a duplication of already existing ones.

Slightly more than half of the respondents (50.5 percent) said having good communication skills is necessary in any business. This is mainly because of the personalised services that most customers anticipate when dealing with small business owners or managers. Financial management knowledge is also considered as key with 47 percent of the respondents mentioning it.

### **Recommendations**

Finally, based on the survey findings and available literature, we propose the following guidelines and strategies that SMEs can use to boost their performance.

It is appreciated that each business has its own unique combination of critical success factors, but some are important for all businesses. First small businesses should have a 'global outlook'. Businesses of all sizes across the globe can interact and share information, technology and products. Small businesses should consider what global trends are affecting availability of resources, increasing or decreasing demand for products or service and where there is an unfilled need one might be able to meet. This may prove a challenge to SMEs but the government can step in here to provide information on business trends.

There is also need to get trained in an area that is relevant to the business carried. This survey has clearly shown managers with relevant training run successful businesses compared to their untrained counterparts. Further, there is need to improve ways of gathering customer information for the purpose of personalized marketing and service. The more a business owner knows about its customers, the better they can meet their needs.

Past researches seem to suggest that access to credit has been a challenge to SMEs. This research however relegates access to credit to fourth place with competition and poor security ranking first and second respectively. Further studies are required to establish if this is the case in rural areas or if the rural areas present unique challenges that are not shared by their urban counterparts.

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## APPENDIX: (Tables)

**TABLE 1: Target population**

Business Category	Business code	Description	Total count
1	110	Medium Trader Shop or Retail Services	15,774
	115	Small Trader, Shop or Retail Service	53,293
3	315	Small Transportation Co.	2,249
	335	Small Petrol Filling	790
	365	Small Storage Facility	813
4	380	Small Communications Co.	158
	415	Small agric. Producer/Processor/Dealer	2,201
5	515	Medium Lodging House With Restaurant Or bar	258
	518	Small Lodging House With Restaurant/Bar	205
	524	Medium Lodging House	305
	527	Small Lodging House Basic Standard	397
	546	Small Restaurant With Bar	917
	549	Large Eating House; Snack Bar; Tea House	522
6	552	Medium Eating House; Snack Bar; Tea House	1,010
	610	Medium professional services firm	437
	615	Small professional services firm	5,166
	630	Medium financial services	406
7	635	Small financial services	443
	735	Small private health facility	52
	740	Doctor/Dentist/Physiotherapist	871
8	760	Small Entertainment Facility	63
	815	Small Industrial Plant	644
	825	Medium Workshop, Services-Repair Contractor	2,907
	830	Small Workshop Service Repair Contractor	8,727
<b>Total</b>			<b>98,608</b>

**Source: Nairobi City Council, Licensing Department**

These business categories are as follows:

1. General Trade, Wholesale, Retail, Stores, Shops, Personal Services:
2. *Hawkers*. There was no statistics in terms of numbers for this group and consequently this group was not sampled.
3. Transport, Storage and Communications
4. Agriculture, Forestry & Natural Resources Extraction:
5. Accommodation and Catering
6. Professional & Technical Services
7. Private Education, Health and Entertainment Services
8. Industrial Plants, Factories, Workshops, Contractors

Other than employees (not exceeding 25), the other criteria considered were industry and space occupied by these businesses. Based on the above criteria, total population for this study was deemed as 98,608 (see Table 3.1)

**TABLE 2: Business performance versus motivation for starting a business**

	Business doing poorly		Business doing well	
	No. of Respondents	%	No. of Respondents	%
To make money	93	57.1%	70	42.9%
To have independence	7	30.4%	16	69.6%
Identified gap in service offering	9	75.0%	3	25.0%
Inspired/challenged by mentors, friends, family	6	66.7%	3	33.3%
Retrenched / lost job	2	13.3%	13	86.7%
To keep me busy	5	10.2%	44	89.8%

**TABLE 3: Challenges facing micro and small businesses**

Most pressing challenges	No. of Respondents	%
Increased competition	177	89.4%
Insecurity	135	68.2%
Debt collection	108	54.5%
Lack of credit	105	53.0%
Power interruptions	89	44.9%
Political uncertainty	82	41.4%
Cost of materials (inputs)	74	37.4%
Hawkers	47	23.7%
Low demand	45	22.7%
Unfavourable business laws	38	19.2%
High transportation costs	33	16.7%
Few customers/Low demand	30	15.2%
Others; high rent charges, lack of water, cost of production, cheap imports, technological challenges, etc.	51	25.0%

**TABLE 4: Ranking of business challenges**

	Ranked 1st		Ranked 2nd		Ranked 3rd	
	No. of Respondents	%	No. of Respondents	%	No. of Respondents	%
Increased competition	67	38%	35	20%	19	11%
Insecurity	31	18%	29	16%	10	6%
Lack of credit	12	7%	18	10%	16	9%
Few customers/Low demand	12	7%	9	5%	9	5%
Debt collection	11	6%	9	5%	5	3%
Rent is too high	8	5%	7	4%	3	2%
Political uncertainty	7	4%	8	5%	6	3%
Power outages	7	4%	10	6%	12	7%
Cost of materials (inputs)	6	3%	11	6%	15	8%
Hawkers	4	2%	5	3%	9	5%
Others (transportation, low speeds of internet, high taxes, etc.)	31	18%	9	5%	5	3%

**TABLE 5: Strategies employed to counter the challenge of competition**

	No. of Responden	%
Good communication	38	30.2%
Give discounts	23	18.3%
Source our own customers	17	13.5%
Do nothing, just accept it	12	9.5%
We sell cheaper than them	10	7.9%
Selling variety of different kinds of products	8	6.3%
Give credit to our customers	7	5.6%
Sell quality things/durable	5	4.0%
Train and give incentives	4	3.2%
Others	19	15.1%

**TABLE 6: Factors that have contributed to Business Success**

	No. of Respondents	%
Disciplined financial management	48	54.5%
Availability of market/customers	30	53.4%
Location/accessibility of the business	37	42.0%
Skilled workforce	34	38.6%
Good business networking	33	37.5%
Competitive pricing /low cost	20	22.7%
Selling variety of products/services	14	15.9%
Availability of capital	6	6.8%
Availability of credit from the banks	4	4.5%
No competition	4	4.5%
Clear vision of what is required	4	4.5%
Reading business magazines	2	2.3%
Attending workshops/seminars	1	1.1%
Focusing on niche market	1	1.1%