INTERNATIONAL JOURNAL OF SOCIAL Sciences and Information Technology
ISSN 2412-0294 www.ijssit.com
http:// www.ijssit.com

EFFECT OF QUALITY OF FINANCIAL INFORMATION ON THE FINANCING POLICY OF WOMEN LED SMALL AND MEDIUM SIZE ENTERPRISES IN KENYA

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Abstract

This study sought to appraise the effect of financial information quality on the financing policy of women led small and medium size enterprises (SMEs) in Kenya. Drawing from a target population of 1746 firms, the study was designed as a cross sectional survey covering a sample of 188 firms down from 290 in the original sample after adjusting for 29 in the pilot test sample group and 73 non responses. It translated to a response rate of 72% which was adequate for testing the hypothesis that the quality of financial information has no significant effect on the debt equity ratio, the proxy of financing policy, of the women led SMEs. Primary data relating to relevance, reliability, understandability and comparability of financial information available to the SMEs as collected using questionnaires were used in the study. After establishing the nature of SMEs using descriptive statistics and ANOVA, the study used a linear regression to test the null hypothesis at 95% confidence interval using the t-statistic and p-value. The study rejected null hypothesis and found out that quality of financial information positively affects the financing policy as proxied by the debt equity ratio. Although useful and innovative in establishing how quality of information affected the financing policy of the SMEs, the study was limited to a cross sectional analysis because of the poor recording keeping aspects of the SMEs and focused only on women led SMEs in Kenya, aspects that may limit the generalizability of the findings. It is recommended that similar studies be done among other spectra of SMEs to provide comparable findings. Regulators need to enhance efforts to facilitate quality of information available to SMEs to help improve their financing policy.

***Keywords**: Quality of financial Information; Financing Policy Debt-Equity Ratio, Financial Performance, Financial Stewards*

I. Background of the Study

Finance theories have shown that business financing policy is a crucial aspect of firm financial performance. In this regard, the firm's financial stewards identify the optimal capital structure that would ensure minimization of the firm's cost of finance, thereby maximizing the firm's revenue (Omowunmi, 2012). Despite this importance, it is not clear how the quality of financial information available to women led SMEs affect such financing policy, especially among women led SMEs in Kenya which play a critical importance in the economic wellbeing of the country. This lack of clarity emanates chiefly from the confounding aspects of conceptual, theoretical and extant empirical literature.

In Kenya, the SMEs have the potential of raising many citizens from the lower economic levels to the mainstream economy (Koech, 2015). A recognition that has made the Government of Kenya (GoK) to strengthen SMEs in Kenya's Vision 2030 by improving their productivity, innovation and performance (Ministry of Planning, National Development & Vision 2030-MPNDV2030, 2007). The SME sector in Kenya has experienced a tremendous growth of enterprises from micro to SMEs to a point that it cuts across all sectors of the economy, providing one of the main sources of employment as well generating widespread economic development in the country (Republic of Kenya -RoK, 2010).

Globally, several studies have investigated firms' financing policy at given points in time. According to Wu (2013), several studies have analyzed the determinants of financing policies. Nawi (2015) conducted as study investigating the determinants of capital structure in small and medium-sized enterprises (SMEs) in Malaysia and their effect on firms' performance. The results reveal that firm characteristics were found to relate to all types of capital structure. Both complete and partial mediating effects are also discovered in this study. The results provide evidence to support the pecking order hypothesis (Myers, 1984; Myers & Majluf, 1984) and agency theory (Jensen & Meckling, 1976). It appeared that SMEs owner-managers in Malaysia do not strive to adjust their capital structure towards some optimal debt ratio, which is contrary to the static trade-off theory of capital structure.

In Kenya, Oluoch (2014) established qualitative accruals quality and its effect of cost of capital which essentially reflects the financing policy of a firm given that debt reliant firms have a low cost of capital while equity reliant firms has a higher cost of capital. Oluoch (2014) used three measures of accruals quality being the innate accruals quality, the discretionary accruals quality and the qualitative accruals quality that was based on the relevance, reliability, comparability and understandability of the accruals information. The findings showed that innate and qualitative accruals quality had an effect of cost of capital while discretionary accruals quality had no effect on cost of capital and therefore it can be inferred that it has no effect on the financing policy. The study however focused on the large firms listed at the Nairobi Securities Exchange and ignored the effect for small firms like the SMEs led by women.

The study is rooted in the life cycle theory of financing while the financing policy of a firm depends on the firm's stage in the business life cycle. Life cycle theory originates from economic literature (Penrose, 1952). The theory is generally used to describe the development of the firm through growth phases or on consumption and savings behavior. In addition, Timmons (2004) asserts that the life cycle model has been advanced to explain the development of financing needs and capital structure of the firm. The model assumes the firm in its early stage of development relies significantly on internal finance. As the firm develops, it is able to obtain more external finance due to less information asymmetries (resulting from the ability of outsiders to scrutinize its creditworthiness). However, firms will use less debt in the later stages of development since they use retained profits to finance investments. This theory is relevant to SMEs as they are opaque and carry high information costs (Psillaki & Daskalakis, 2009), especially those with a relatively short historical performance.

There are quite a number of previous studies supporting the applicability of the life-cycle model in explaining the financing decisions of SMEs (Mac anBhaird & Lucey, 2010). Berger and Udell (1998) used data from several US datasets to explain how firm financing avenues change over time. They demonstrated that, financing choices and needs change as a firm grows in size, gains more experience and becomes more transparent. However, Gregory et al, (2005) maintained that, it is not possible to contain the life-cycle of SMEs in one model, as implied by Berger and Udell (1998). The model is unable to present a full scenario with reference to the relationship between firm characteristics and capital structure.

The study is based on the conceptual relationship between quality of financial information and financing policy as indicated by the debt-equity ratio. This is depicted in figure 1.

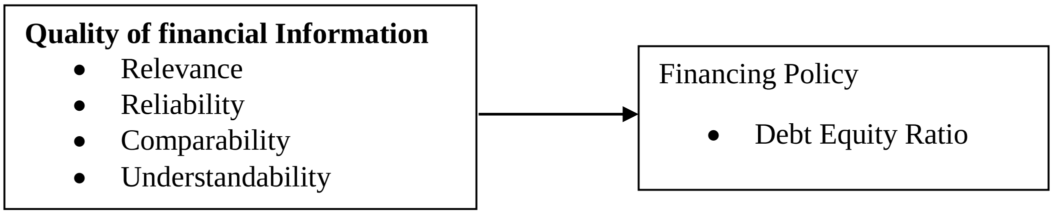

Figure 1: Conceptual Structure

Quality of financial information relates to the ability of financial information to be useful to the various users for economic decision making (Oluoch, 2014). According to Oluoch (2014), there are two types of qualities of financial information. These are the content qualities and the presentation qualities of information. With respect to the content qualities, he asserts that information must have attributes of relevance and reliability for the content to be useful to the decision makers. This is going to be the case if the information is provided on a timely basis, has elements of forecast value as well as attributes of confirmatory value. Oluoch (2014) goes ahead to assert that reliable information is that which is factually accurate and is dependable for its faithful representation of the financial condition of the business. This is the case if the information is neutral, complete, is faithfully represented and has elements of financial conservatism.

Presentation characteristics reflect the ability of information to be presented in such a manner as to make it useful for decision making. In line with Oluoch (2014), information is said to be having desirable presentation attributes if it not only is understandable, but it is also comparable on a time series basis as well as on a cross sectional basis with other similar firms. It is these quartet of qualities (relevance, reliability, comparability and understandability) that are used in this study to assess the quality of information available to women led SMEs in Kenya.

With respect to financing policy, according to inertia theory of capital structure, firms avoid any action to change their capital structure because of transaction costs (Welch, 2004). The latter implies that a firm's capital structure is changed by retained earnings and stock price changes, which alter the size of a firm's assets. As suggested in the inertia theory as well as pecking order theory, using internal funds is the best financing policy and both trade-off and pecking order theories suggest that, debt issuance is the better policy, rather than equity issuance. This equity-issuing phenomenon cannot be explained by either the pecking order or inertia theory, where firms accumulate retained earnings when there is significant asymmetric information. A possible explanation for this result is that the financial distress risk increases globally in terms of the trade-off theory, or that asymmetric information costs are not great in terms of the pecking order theory. In fact, the best financing policy in the pecking order theory is issuing over-priced equity.

II. Objectives of the Study

The study sought to establish the effect of quality of information on the financing policy of women led SMEs in Kenya. It is hinged on the reality that the quality of financial information is based on its relevance, reliability, comparability and understandability as set in the conceptual framework of accounting stipulated by the International accounting Standards Board (IASB, 2018). It is from this that the study hypothesizes that the quality of financial information has no significant effect on the financing policy of the women led SMEs.

III. Methodology

This study is rooted in the positivism philosophy. This philosophy according to Sekaran (2013) can also be called quantitative, objectivist, scientific or traditionalist philosophy. It was adopted because the descriptive approach adopted as the research design perfectly falls in the scientific category where the test of the hypotheses is able to tell the cause-effect relationships of the study. The approach draws from the research methodology available for scientific research. This study used a descriptive research design (describing the characteristics of existing phenomenon) in soliciting information on addressing effect of quality of financial information on the financing policy of women owned SMEs.

The target population was 1,746 SME women business owners. Most of the self-employed persons are engaged in livestock trade, business retail and wholesale trade, horticulture / floriculture, industrial activities and Jua kali and tourist sector-sale of beads. Currently, there are limited employment opportunities in the County and efforts need to be intensified to create off-farm employment through establishment of small-scale enterprises' diversification (County Government of Kajiado, 2013).

Using the Sekeran (2013) approach, a sample of 290 was obtained based on simple random sampling. The analytical model is specified as

$$Y = \beta_0 + \beta_i X_i + e$$

In this case Y is the debt equity ratio while X is the Likert scale score for quality of financial information based on relevance, reliability, understand ability and comparability of information.

Various interpretations were made based on regression results to establish the significance, at the 95% confidence level (i.e. 0.05 level of significance) of the independent variables in determining the dependent variable. The Statistical Package for Social Sciences (SPSS) software version 21.0 was used to analyses the data.

IV. Findings and Discussion

The initial sample size as determined from chapter three was 290. In line with Sekaran (2013), 10% of these were used in pilot testing. Accordingly, the remaining 261 were used in the actual study. 201 of these were returned representing 77.01 response rate. Out of these, 13 were not valid due to inappropriate filling. This left only 188 valid responses for the analysis. This translates into a valid response rate of 72.03%. This response was considered satisfactory because Werner, Praxedes and Kim (2007) indicate that response rates of at least 60% are satisfactory and useful in drawing conclusions generalizable on the entire study sample.

The financing policy of the women led SMEs was indicated by the ratio of debt used by the firm's to equity as indicated by the owner's funds. The findings about the mean, the median, the standard deviation and the coefficient of variation are provided in table 1.

Table 1: Firm Financial Structure Descriptive Statistics

	FP
Mean	0.21124
Median	0.11712
Standard Deviation	0.24535
Coefficient of Variation	1.16147

Count	188
Confidence Level (95.0%)	0.03530

Results show that mean of the debt equity ratio was 0.21124 while the median was 0.11712. This indicates that the ratio is skewed to the left a clear indication that a majority of the firms rely of equity rather than debt to finance their firms. This indicates that the dominant form of financing among the women led SMEs is equity. This finding seems to agree with what Hogan and Hutson (2005) found among the Irish firms that in the Irish Software sector, firms finance more by equity rather than debt. It however contradicts the Modigliani and Miller (1958) hypothesis that capital structure is an irrelevant financial decision.

On the overall, the descriptive findings of quality of information spanning relevance, reliability, understandability and comparability attribute are reflected in Table 2 which shows the composite data relating to relevance, reliability, understandability and comparability.

These four were used to form an accounting information quality index whose descriptive statistics are reflected in table 2.

Table 2. Overall Descriptive Statistics on Quality of Financial Information

	QI
Mean	0.37409
Median	0.37917
Standard Deviation	0.03731
Coefficient of Variation	0.09974
Count	188
Confidence Level (95.0%)	0.01927

The values are scaled by a constant of 10 to be in line with the other variables used in the study which are basically ratios. Sekaran (2013) suggests this scaling approach when combining Likert scale data and ratio or index based data. The findings provide a scaled mean of 0.37409 or a non-scaled value of 3.7409. This is indicative of the finding that on average, the SMEs led by women find financial information at their disposal to be quite useful for decision making with respect to their financing options as between debt and equity.

When understood from the behavioral orientation angle, the reality may be that the quality may not be as high as portrayed by the study given that Sloan's (1996) functional orientation theory presupposes that users of information fixate on particular figures especially the profit and may miss out a great detail of the other aspects of financial information. Holding these behavioral reservations constant, the findings in table 2 point to a relatively high quality of information as is confirmed by the low level of the coefficient of variation.

The last analysis in the study involved evaluation of the stand-alone effect of the quality of information available to women led SMEs on the finance policy of those firms. The findings are established in Table 3. The model reveals a weak coefficient of correlation of 0.19457 which translates into a coefficient of determination of 0.03786. The implication of this is that 3.77% of the changes finance policy as indicated by the debt equity ratio are caused by changes in firm quality of financial information as indicated by the quality of information index. The coefficient of correlation shows a positive correlation such that as firm size increases so does the reliance of debt as opposed to equity. This is in agreement with Hogan and Hutson (2005) who found among the Irish firms that in the Irish Software sector, firms finance more by equity rather than debt. It however contradicts the Modigliani and Miller (1958) hypothesis that capital structure is an irrelevant financial decision

Table 3: Simple Linear Regression of Financial Structure on Information Quality

Multiple R	0.19457					
R Square	0.03786					
Adjusted R Square	0.03268					
Standard Error	0.24130					
Observations	188					
	df	*SS*	*MS*	*F*	*Signf F*	
Regression	1	0.42612	0.42612	7.31821	0.00746	
Residual	186	10.83035	0.05823			
Total	187	11.25647				
	β	*Std Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	0.16845	0.02366	7.11868	0.00000	0.12177	0.21513
QI	0.35634	0.13172	2.70522	0.00746	0.09648	0.61620

The data fits the model very well because the model F ratio of 7.31821 is greater than the critical value of F shown in table 3 as 0.00746. Based on this F test the null hypothesis that the simple linear regression cannot be used in relating firm quality of financial information to finance policy is rejected with the conclusion that the model is suitable for analysis.

Using the t-test at 95% confidence interval, the fixed term is set at 0.16845 while the coefficient of the size indicator is established at 0.35634. Their respective t-statistic values are 7.31821 and 2.70522. The critical t at 187 degrees of freedom from the standard t-tables is 1.973. Accordingly, the study finds that quality of financial information (quality index) has a positive effect on the finance policy (debt-equity ratio) of the women led SMEs since the regression t is greater than the standard t. This is confirmed by comparing the p-value to 0.05, the level of significance at 95% confidence interval. Since the P-value of 0.00746 is less than significance level (0.05), the null hypothesis that firm information quality has no effect on finance policy is rejected with the conclusion that it indeed has a positive effect on the debt-equity ratio that reflect the finance policy of the firm. The implication is that as the quality of financial information of the firm increases through an enhanced accounting policy, so does the proportion of debt in the overall capital of the SME.

V. Conclusion

Quality of information available to SMEs is very critical in supporting the soundness of the resultant financial policy and other decisions made by the SMEs. At the heart of quality information lies the sub-qualities of relevance, reliability, understandability and time series as well as cross sectional comparability of information. From the summary indicated in table 3, it can be seen that information quality had a positive effect on the financing policy of the women led SMEs. Accordingly, the null hypothesis that firm information quality has no effect on finance policy is rejected with the conclusion that it indeed has a positive effect on the debt-equity ratio that reflect the finance policy of the firm. The implication is that as the quality of financial information of the firm increases through an enhanced accounting policy, so does the proportion of debt in the overall capital of the SME.

Ultimately, the study in line with the last objective concludes that the quality of financial information positively affects the financing policy of a firm as indicated by the debt equity ratio. That to make better financing decisions, it is incumbent upon the women led SMEs to improve the quality of their information possibly by employing and deploying competent accounting and internal audit departments. The conclusion from the study is that as the relevance, reliability, understand-ability and comparability of financial information increases, so is the ability to make high quality decisions with respect to the debt-equity mix to be used by a firm.

The study recommends that firms must strive to maintain high quality financial and accounting records. This is especially the case because the findings indicate that relevance, reliability, comparability and understand ability of financial information have a big influence on financing policy of businesses in general and SMEs in particular.

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ISSN 2412-0294
Vol IV Issue XI, November 2018

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