Investment Appraisal Techniques and Financial Performance of Small and Medium Enterprises in Nairobi City County, Kenya

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ABSTRACT

Small and Medium Enterprises play a major role in the social economic development of any country, however these enterprises face investment decision problems which inhibit their financial performance. Poor investment decisions have been blamed for high rate of failure and closure. Thus, the purpose of the study was to determine the effects of investment appraisal techniques and financial performance among small and medium enterprises in Nairobi County, Kenya. The objectives of the study were to: determine the effect of Accounting Rate of Return, payback period, Net Present Value and Internal Rate of Return on financial performance among small and medium enterprises in Nairobi County, Kenya. The information that provided by this research will benefit policymakers, community members and academicians. The study adopted cash flow theory of investment, Theory of Investment Decisions, Agency Theory and Q Theory of Investment. It adopted a descriptive survey research design with a target population of 71,195 licensed Medium Enterprises with Nairobi County. The sample size was 384 Small and Medium Enterprises. The researcher adopted cluster random sampling technique and collected data using questionnaires. The instruments were validated by the supervisors. Reliability of the instruments was determined through a pilot study where a Cronbach alpha coefficient of 0.7 was considered appropriate. Quantitative data was analyzed using descriptive statistics and inferential statistics and presented in tables. The study revealed that Accounting Rate of Return (t =6.702, P<.05), payback period (t =16.489, P<.05), Net Present Value (t =3.295, P<.05) and Internal Rate of Return (t =2.133, P<.05) significantly affect financial performance among SME’s in Nairobi County, Kenya. Besides, these results imply that payback period is most (t =16.489, P<.05) important predictor for financial performance. The study recommends that the government and other service providers such as Small Industries Development Organization to focus more on the issue of investment decisions for small and medium enterprises. In particular, they should train small and medium enterprises on the investment evaluation techniques, their advantages and disadvantages in relation to their financial goals.

Key Words: Investment Appraisal Techniques, Financial Performance, Small and Medium Enterprises in Nairobi City County

1. INTRODUCTION

Holmes and Nicholls (2009) in his study on SMEs in the UK summarize that management accounting information is associated with success and failure in SMEs depending upon how they are produced and utilized in their companies. However, Horngren (2005) on his study on SME financial analysis standards in the USA argues that cost accounting or management accounting concepts and techniques are neutral instruments. It is not the cause of poor management but primarily symptoms since it may be used wisely or stupidly by managers of
the firms. Drury and Tayles (2005) on their study on financial reporting and investment analysis for SMEs in Canada, concludes that the same rules and procedures established for external reporting (financial accounting) are likely also to be applied to internal reporting (management accounting). Though external and internal reporting tend to employ the same rules, it does not mean that management accounting is subservient to financial accounting. The reason that most companies adopt the identical practices for both reporting systems is that firms prefer their internal profit to be reported consistently with external financial accounting requirements in order that they will be comparable with outsiders’ assessments of overall company performance. In the other words, companies would like to be ensured that internal accounting system do not have any conflicts with external financial accounting requirements. The other issue in management accounting practices is budgeting. Szychta (2002) in his study of manufacturing and service enterprises in Poland found that these enterprises prepare annual operating financial budgets for the whole enterprises. Also a complete or nearly complete master budget is prepared by a much smaller proportion of enterprises. The rest of them prepare sales, production and cost budgets. Unlike Polish companies, Japanese firms are less extensive in use of financial budgeting (Yoshikawa, et al., 1989). The key issues in internal reporting are addressed in monthly and annual reports. However, the inadequately related budgeting and reporting system indicated that many companies failed to use accounting information systematically for clearly defined and useful purposes (Haldma and Laats, 2002).

For performance measurement and evaluation, most companies based the measurement on different functions and product groups, to somewhat lesser extent on client groups and sales regions (Haldma and Laats, 2002). Net profit, rather than controllable profit, is widely used to evaluate the performance of divisional managers (Drury and Tayles, 1995) since it could be apparently measured in monetary value and, sometimes, it is not possible to allocate and designate which costs are controllable or uncontrollable for a particular manager. In Small and Medium Enterprises (SME’s), for both individual and overall economy, in order to reduce chances of collapse investment decisions becomes a requirement, thus, investment decisions are among the most important decisions to be made by the SME’s as they influence the financial performance of the SMEs (Katabi & Dimoso, 2016). Investment Appraisal Techniques remain sensitive in SME’s investment decision as its planning guarantees knowledge on how the business finances look like and what to invest in without causing a strain on itself (Yaqub and Husain, 2010). The SME sector is highly an essential sector in job creation and production of goods and services in numerous economies in the world and in China the undisputed second largest economy on Earth. Investment Appraisal Techniques used by the SME have been found to have a positive impact on financial performance, hence becomes a requirement in investment decision. Despite, the study, there exist some serious gaps in the previous studies regarding this research area (Chung & Huang, 2010). This is also evident in America, where a study on 88 American firms revealed a statistical significant relationship between the adoption of Investment Appraisal Technique and financial performance, thus a basis for investment decisions (Gill A. et al2010). In Tanzania, decision among SMEs to invest in a given project is of great concern and therefore, calls for SMEs owners’ training on advantages and disadvantages of various investment evaluation techniques such as the discounted and non-discounted Cash Flow methods (Isaga, 2012).

Despite their importance in the economy of the country, SMEs in Tanzania face problems such as finance and knowledge on the decision to invest which inhibit their growth and success (Katabi and Dimoso, 2016). Also it might be possible that if owners do not know how to make investment decisions and the link thereof between the financial goals and
investment decisions, even if they are given sufficient capital, businesses may continue having problems (Maziku, 2012). UNDP (2015) indicates that in Kenya SMEs comprise of both formal and informal business, but a majority of the SMEs operate informally. These are concentrated within the urban centers due to better service and infrastructures as compared to the rural areas; majority of the SMEs operate within the same sphere. The high population in the urban center makes a ready market for the SMEs products and services. SMEs have a significant contribution to the national economy. Majority of the SMEs are a mixture of dynamic enterprises involved in an array of activities but largely within the service sector transport and communication, wholesale and retail trade, manufacturing, construction, finance, real estate, community and personal services and insurance (KIPPRA 2013 and KNBS 2014).

SME in Kenya contribute 80% of employment and contributes about 40% to GDP (Mwarari & Ngugi, 2013 and Kenya Economic Survey, 2011). They are efficient and prolific job creators, the seeds of big businesses, and the fuel of national economic engines (Abor and Quartey, 2010 and IFC, 2010). In regard to the national and small enterprise baseline survey (GoK, 2007), approximately 1.3 million small enterprises were in Kenya and employs about 2.4 million people, SME survey basic report (KNBS, 2016). In Nairobi County, SMEs employs over 4.6 million people which is over 30% of all employment and accounts for approximately 75% of all businesses (Kiveu, 2013). Nairobi City Government estimates that there are 101,450 SMEs within the County (Nairobi City County, 2014). Despite the statistics on the importance of SMEs in Kenya, inappropriate Investment Appraisal Techniques are lamented for their short operation period as 57% of small businesses are in stagnation with only 33% of them showing some level of growth (Kihonge, 2014 and Ahiawodzi & Adade, 2012). Thus, a study on Investment Appraisal Techniques and financial performance of SMEs in Nairobi County.

2. STATEMENT OF THE PROBLEM

Small and Medium Enterprises play a major role in the social economic development of any country, however these SMEs face problems which inhibit their growth and success (Isaga, 2012). Poor investment decision has been blamed for high rate of failure and closure. It might be possible that if owners do not know how to make investment decisions and the link thereof between the Investment Appraisal Techniques and investment decisions, even if they are given sufficient capital, businesses may continue having problems (Guda, 2013). Kenya National Bureau of Statistics (Republic of Kenya, 2015) indicates that there is high rate of failure and stagnation among many SMEs as most of them close in their first three years of operation. Besides, poor investment decisions has been a challenge among SMEs in Nairobi (Keter, 2013) as SMEs are faced with the threat of failure; three out five fail yearly within the first few months of start (Nyagah, 2013). Investment decisions are among the three most fundamental decisions that a SME does take on its usual day to day operations, the other two fundamental decisions are the financing decisions and the operational decisions. According to Girald (2011) and Evans (2012), the adoption of Investment Appraisal Technique is the initial requirement that should be considered prior to starting an investment exercise. Studies by Katabi and Dimoso (2016), revealed that most SMEs use investment evaluation techniques such as payback period, accounting rate of return, Internal Rate of Return and Net Present Value or combination of methods when making investment decisions for enhanced financial performance. However, John (2007) and Kipesha (2009), noted that that most SMEs do not use investment evaluation techniques when making investment decisions for enhanced financial performance. This study thus, necessary to further assessed points of non-consensus on the adoption of Investment Appraisal Techniques and financial performance. This inspired
the need to design the current research to fill in the existing gap by assessing Investment Appraisal Techniques and financial performance among Small and Medium Enterprises in Nairobi County, Kenya.

3. OBJECTIVES

The general objective was to determine the effect of Investment Appraisal Technique and financial performance among Small and Medium Enterprises in Nairobi County, Kenya.

The specific objectives of the study were:

i. To determine the effect of Accounting Rate of Return on financial performance among SME’s in Nairobi County, Kenya.

ii. To establish the effect of payback period on financial performance among SME’s in Nairobi County, Kenya.

iii. To ascertain the effect of Net Present Value on financial performance among SME’s in Nairobi County, Kenya.

iv. To examine the effect of Internal Rate of Return on financial performance among SME’s in Nairobi County, Kenya.

4. THEORETICAL REVIEW

The study was anchored on the conventional capital budgeting theory, neo-classical theory and the Tobin’s Q theory.

4.1 Conventional Capital Budgeting Theory

Woods & Randall (1989) established that in capital budgeting, the NPV criterion is used to measure shareholder’s wealth which is the main objective in financial management. The riskiness of projects cash flows is equal to the firms’ riskiness of other assets cash flows and the firms WACC is used to calculate NPV. Some future investment opportunities (FIOs) are acknowledged by the market due to their uncertainty and risk perceptions. Conventional Capital budgeting approaches are biased towards FIOs in the long term in potential opposition to shareholder’s interests. Therefore, discounting ought to be done at the required return on equity (Ke) rather than WACC (Ka) to determine shareholders’ wealth attributable to FIOs. The ability to borrow on FIOs basis would increase shareholders wealth by quantifiable amount, if the management has a clear incentive to increase its credibility in the financial markets. When management is either unwilling to divulge information or unable to convince markets of future cash flows, a divergence will exist between the market value of shares and true shareholder wealth (Woods & Randall, 1989).

4.2 Neoclassical Theory of Investment

The Neoclassical theory of investment could be based on the optimal capital accumulation (Jorgenson, 1963). Neoclassical theory of investment is based on the assumption of profit-maximizing behavior by firms (Samuel, 1996) and the assumption that the management seeks to maximize the present net worth of the firm. Hence, an investment project should be undertaken if and only if it increased the value of the shares (Tobin, 1969 as quoted by Yoshikawa, 1980). Danielson and Scott (2006) put it clear that, the firms will make set of investments decisions that will maximize shareholders wealth. Hence, the rule is invest in all positive net present value projects and reject those with a negative net present value. The neoclassical model of optimal capital accumulation may be derived by maximizing present value of the firm, by maximizing the integral of discounted profits of the firm, or simply by maximizing profit at each point of time (Jorgenson, 1967; Eklund, 2013). There are two assumptions regarding the theory of investment decisions as highlighted by Danielson and
Scott (2006), first, the primary goal of a firm’s shareholder is to maximize firm value; second, a firm has access to perfect financial markets allowing it to finance all value enhancing projects. A number of investment criteria can be used by businesses when making investment decisions. These criteria may be grouped into two; Discounted cash flow criteria and Non-discounted cash flow criteria (Pandey, 1976). Under the discounted cash flow criteria there are the following methods: Net Present Value (NPV), Internal Rate of Return (IRR), Modified Internal Rate of Return (MIRR), and Profitability Index. While under the non-discounted cash flow methods are as follows; Pay Back (PB) and Accounting Rate of Return (ARR).

4.3 Tobin’s Q Theory of Investment

This Theory relates to the rate of investment as a function of Q, where Q is the ratio of the market value of new additional investment goods to their replacement cost (Tobin, 1969). If investors value assets at prices which are greater than replacement costs, then there are strong inducements for investment in reproducible real capital (Ciccolo et al 1979). This theory was in sharp contrast to the output-oriented models like neoclassical model and acceleration model in that it attempted to explain investment on a financial basis in terms of portfolio balance; this translates to the concept based on the q ratio; that is the ratio of the market value of capital to its replacement cost. Grunfeld (1960) proposed the use of the firm’s market value as proxy for potential investment undertakings and further stated that investment depends on the market value of the firm in a direct correlated way, this approach to investment being influenced by the market value of the firm can be seen as a relation to Tobin’s Q theory. While the accelerator, neoclassical, modified neoclassical, and the cash flow models do not explicitly consider the optimal adjustment path for the firm's capital stock when it is away from that level, the Q theory characterizes the complete evolution of the capital stock from the underlying optimization problem of investments differ from the preceding investment models such as the accelerator models and Jorgenson’s model in that it is not output-based. In contrast, investment is thus not viewed as a function of output as in the previous 24 models, but instead assumed to be determined by the firm’s market value (Karin et al. 2008). The contrast is also elaborated by (Clark, 1979) where he states that the Q models should not be viewed as complements but rather substitutes to the standard neoclassical models.

5. CONCEPTUAL FRAMEWORK

Investment appraisal techniques had been found to be one of the most important capital budgeting techniques that were likely to influence financial performance among SMEs (Olawale et al. 2010). Amuzu (2010) adopted Accounting rate of return, Payback period, internal rate of return and Net present value as the investment appraisal technique that influence financial performance. Therefore, in this study, investment appraisal techniques were the independent variable while financial performance was the dependent variable. In the Conceptual Framework below, it was anticipated that the use of the investment appraisal techniques influence the financial performance of the SMEs.
6. RESEARCH METHODOLOGY

This study used descriptive survey research design. This research design was used since it describes the situation as it were, is and how it is likely to be. The findings inform the outcome. Therefore, the approach enabled the study to assess the cash flow methods and investment decision by SMEs. The basic concern of this study was to assess the relationship between Investment Appraisal Techniques and investment decisions of SMEs in Nairobi County, Kenya. The study adopted multiple linear regressions that assisted the researcher reach to conclusions. A discrete choice model was employed in this study to analyze investment decision behavior. The study population was 71,195 licensed SMEs with Nairobi County. Nairobi County consists of 17 constituencies namely: Langata, Kibra, Roysambu, Kasarani, Ruaka, Embakasi South, Westlands, Dagoretti South, Embakasi North, Embakasi Central, Embakasi East, Embakasi West, Makadara, Kamukunji, Starehe and Mathare (Nairobi County Council Licensing Department, 2013). The respondents will be the proprietors of the SMEs selected.

The study employed cluster sampling technique in selecting a sample from the target population. The sampling technique was considered because of its diversity consideration within a target population and selected those clusters that are representative of the entire populations considering the constraints faced. Stratified random sampling technique was adopted within the clusters to ensure that all sectors that SMEs operate in are included in the sample. Stratification was achieved at this by grouping the heterogeneous population into homogenous subsets (per sector) to ensure representativeness. Random sampling technique was used to sample individual SMEs within the stratum as it eliminated bias since each member of the target population has an equal chance or probability of being selected.
statistical justification for this was a constraint on time to cover all the possible SMEs. In addition it gave us a wide range of views from a cross section of the SMEs. This research study adopted Fishers Formula, as stated in Kothari R. (2007), to determine the respondents sample size of the population greater than 10000 at 95% confidence level of significance and confidence interval/margin error of 5%.

\[ n = \frac{Z^2pq}{d^2} \]

Where

\( n \) = the desired sample size

\( Z \) = the standard normal deviate at the confidence level of 95% = 1.96

\( p \) = the proportion in the population estimated to have characteristics being measured is 50%

\( q = 1 - p \)

\( d \) = Level of precision set at 0.05

\[ n = \frac{(1.96)^2 x .5 (.5)}{.05^2} \]

\[ = 3.8416 x .25 / 0.0025 \]

\[ = .9604 / 0.0025 \]

\[ = 384.16 \text{ (rounded off to a whole number)} \]

\( n = 384 \) SMEs and hence respondents

7. FINDINGS

7.1 Correlation Analysis

Pearson’s product moment correlation coefficients were used to test linearity assumption. The purpose of using correlation was to identify Investment Appraisal Techniques that provide best predictions for conducting regression analysis. The inter-correlations among the variables are shown in Table 1.

<table>
<thead>
<tr>
<th>Table 1: Test for Normality</th>
<th>Financial performance</th>
<th>Accounting Rate of Return</th>
<th>Payback Period</th>
<th>Net Present Value</th>
<th>Internal Rate of Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial performance</td>
<td>Pearson Correlation</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>356</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounting Rate of Return</td>
<td>Pearson Correlation</td>
<td>.768**</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>356</td>
<td>356</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payback Period</td>
<td>Pearson Correlation</td>
<td>.864**</td>
<td>.757**</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>356</td>
<td>356</td>
<td>356</td>
<td></td>
</tr>
<tr>
<td>Net Present Value</td>
<td>Pearson Correlation</td>
<td>.684**</td>
<td>.448**</td>
<td>.479**</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
As shown in Table 1, there is a correlation between Accounting Rate of Return and financial performance ($r = 0.768^{**}$), Payback Period and financial performance ($r = 0.864^{**}$), Net Present Value and financial performance ($r = 0.684^{**}$) and Internal Rate of Return and financial performance ($r = 0.683^{**}$). This implies that the linearity assumption was therefore, satisfied. After the assumptions, the study established the effect of Investment Appraisal Techniques and financial performance.

**7.2 Regression Analysis**

Multiple linear regression analysis was used to test the formulated hypotheses. First, the model summary was analyzed to establish the strength of the conceptualized Investment Appraisal Techniques in predicting financial performance.

Table 2: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
<th>Durbin-Watson</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.927</td>
<td>.860</td>
<td>.858</td>
<td>.196</td>
<td>2.006</td>
</tr>
</tbody>
</table>

*a. Predictors: (Constant), Internal Rate of Return, Accounting Rate of Return, Payback Period, Net Present Value
b. Dependent Variable: Financial performance*

Results presented in Table 2 reveal that the four Investment Appraisal Techniques namely Accounting Rate of Return, Payback period, Net Present Value and Internal Rate of Return explains 85.8% of the variation in financial performance (Adjusted R Square = 0.858). Therefore, the remaining 14.2% is explained by other Investment Appraisal Techniques not considered in the study. Second, the ANOVA output was examined to check whether the proposed model was viable.

Table 31: Analysis of Variance (ANOVA)

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>82.576</td>
<td>4</td>
<td>20.644</td>
<td>538.428</td>
<td>.000b</td>
</tr>
<tr>
<td>1</td>
<td>Residual</td>
<td>13.458</td>
<td>351</td>
<td>.038</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>96.034</td>
<td>355</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*a. Dependent Variable: Financial performance
b. Predictors: (Constant), Internal Rate of Return, Accounting Rate of Return, Payback Period, Net Present Value*
Results shown in Table 3 reveal that the F-statistic was highly significant (F= 538.428 p<0.05), this shows that the model was valid.

Table 4: Regression coefficients

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>.039</td>
<td>.068</td>
<td>.574</td>
<td>.566</td>
<td></td>
</tr>
<tr>
<td>Accounting Rate of Return</td>
<td>.153</td>
<td>.023</td>
<td>.209</td>
<td>6.702</td>
<td>.000</td>
</tr>
<tr>
<td>Payback Period</td>
<td>.435</td>
<td>.026</td>
<td>.542</td>
<td>16.849</td>
<td>.000</td>
</tr>
<tr>
<td>Net Present Value</td>
<td>.194</td>
<td>.059</td>
<td>.204</td>
<td>3.295</td>
<td>.001</td>
</tr>
<tr>
<td>Internal Rate of Return</td>
<td>.122</td>
<td>.057</td>
<td>.133</td>
<td>2.133</td>
<td>.034</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Financial performance

Results of the regression coefficients presented in Table 4 shows that the estimates of β values and give an individual contribution of each predictor to the model. The β value tells us about the relationship between financial performances with each predictor. The β value for Accounting Rate of Return (.209), Payback period (.542), Net Present Value (.204) and Internal Rate of Return (.133) were positive. The coefficients for each of the variables indicates the amount of change one could expect in financial performance given a one-unit change in the value of that variable, given that all the variables in the model are standardized basing on the standardized coefficients. Results reveal standardized regression coefficient for Accounting Rate of Return (β=0.209), implies that an increase of 1 standard deviation in Accounting Rate of Return is likely to result in a 0.209 standard deviations increase in financial performance.

Moreover, standardized regression coefficient for Payback period (β=0.542), implies that an increase of 1 standard deviation in Payback period is likely to result in a 0.542 standard deviations increase in financial performance. Likewise, standardized regression coefficient for Net Present Value (β=0.204), implies that an increase of 1 standard deviation in Net Present Value is likely to result in a 0.204 standard deviations increase in financial performance. Lastly, standardized regression coefficient for Internal Rate of Return (β=0.133), implies that an increase of 1 standard deviation in Internal Rate of Return is likely to result in a 0.133 standard deviations increase in financial performance. T-test was used to identify whether the predictors were making a significant contribution to the model. When the t-test associated with β value is significant then the predictor is making a significant contribution to the model. The smaller the value of significance (the larger the value of t) meaning greater is the contributor of that predictor. The results show that Accounting Rate of Return (t =6.702, P<.05), payback period (t =16.489, P<.05), Net Present Value (t =3.295, P<.05) and Internal Rate of Return (t =2.133, P<.05). These findings indicate that Accounting Rate of Return, Payback period, Net Present Value and Internal Rate of return as predictors, which significantly affect financial performance among SME’s in Nairobi County, Kenya.

These results imply that payback period is most (t =16.489, P<.05) important predictor for financial performance. This could be due to the simplicity of the payback period method when making an investment decision as opposed to Internal Rate of Return which has a lot of
calculations that could not be understood by most of the SMEs. This is line with the findings of Daniel and Scott (2006) who observed that small firms evaluate projects using payback period or owner’s NPV. Vos & Vos (2000) found that NPV and accounting based methods were mostly used. Graham and Harvey (2001) observed that small businesses are significantly less likely to use NPV method but they frequently use the payback period method. Collinearity, tests were carried out using tolerance and Variance Inflation Factor (VIF) statistics. For this model, VIF values are all below 10 and tolerance statistics are all well above 0.1 and we can conclude that there is no Collinearity within our data.

8. CONCLUSION

In regard to the literature review, findings and discussions, the study concluded that Investment Appraisal Techniques significantly influence the financial performance of SMEs in Nairobi County, Kenya. Therefore, sensible investment decisions are vital in the improvement of the SMEs solvency, market, liquidity and profitability which results to better financial performance. Moreover, payback period remains the most important predictor of the SMEs financial performance. On the effect of Accounting Rate of Return on financial performance, the study concluded that, Accounting Rate of Return significantly influence financial performance. SMEs do consider cash inflows, initial cash to be invested and sometimes wear and tear when investing, however, they fail to take into account time value of money. Therefore, Accounting Rate of Return plays some positive role in improving SMEs financial performance.

On the effect of Payback period on financial performance, the study concluded that, payback period significantly influence financial performance. SMEs do consider cash generated from sales, total cost spent in establishing the project/business, estimation of the time it took to get back the money invested and capital employed when making an investment decisions. Therefore, Payback period plays a great positive role for enhanced financial performance. Moreover, the study concluded that, Net Present Value significantly influence financial performance. SMEs do consider discount rates, wear and tear when investing; however, they fail to consider summing up all the present values to get the present value of cash stream and time value for money when making an investment decision. Therefore, Net Present Value plays a divided role in improving SMEs financial performance. Lastly, the study concluded that, Internal Rate of Return significantly influence financial performance. SMEs do consider some components of Internal Rate of Return such records on yearly projected returns and wear and tear, however, they fail to consider rate of return from the business and the NPV to be equal to zero when making an investment decision. Therefore, Internal Rate of Return plays a divided role in enhancing SMEs’ financial performance.

9. RECOMMENDATIONS

The findings of the study suggested that due to the importance of investment to the economy of the country and SMEs themselves; SMEs operators need to continuously analyze the investment decisions that make them improve their financial performance. The government and other stakeholder to focus more on the issue of investment decisions for SMEs. In particular, they should train SMEs on the investment evaluation techniques, their advantages and disadvantages in relation to their financial performance. Knowing these factors of influence will enable SMEs to make better investment decisions by selecting the right investment evaluation technique. More efforts are needed from the regulatory agencies and government in general toward helping SMEs grow and make decisions as their growth will be good for the wider economy.
REFERENCES


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