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RESEARCH ARTICLE

OPERATIONAL RISK MANAGEMENT PRACTICES AND PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KAKAMEGA COUNTY

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ABSTRACT

Risk management has been identified as a vital process in the business institutions despite being less developed within the small business sector. Many developed countries record a time in history when entrepreneurial activities led to high economic development. This means that management of Operational Risk in Small and Medium Enterprises in developing countries and more so in Kenya can also lead to high economic development. It has been generally observed that most Small and Medium Enterprises (SMEs) do not survive to their fifth birthday (Hallberg, 2000) hence raising concern on their general performance. This article therefore investigates the effects of Operational Risk Management (ORM) practices on the performance of Small and Medium Enterprises. A cross-sectional survey design was adopted to establish the relationship between the key study variables. The primary data used in the analysis is based principally on a stratified random sample of 100 Small and Medium Enterprises respondents interviewed in 2015 in Kakamega Town. A range of secondary data sources served as the key bibliographic tools for identifying relevant work for review. Multivariate regression analysis was used to test the effect of the Operational Risk Management practices on the performance of Small and Medium Enterprises. The results show that there was a statistically significant positive effect of Operational Risk Management practices on the performance of Small and Medium Enterprises (overall beta value of 0.621 and significant). Given that there is a positive effect of regulatory compliance on the performance of Small and Medium Enterprises for instance, the government should proactively engage in creating a conducive environment in which the Small and Medium Enterprises operate.

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INTRODUCTION

According to the Government of Kenya (2005), Small and Medium Enterprises (SMEs) contribute significantly to a nation's gross Domestic product (GDP). Ashton, sung, and Raddon (as cited in Matlay, 2004. P.504) contend that the high degree of proliferation of SMEs in both developed and developing countries has attracted policy and academic interest focusing on their performance. Hill and Stewart (2000, p.105) say that most researchers define SMEs based on employee numbers. It is on the basis of this that an SME in this study is defined as an enterprise employing one person and not more than 50 persons. Dickinson (as cited in Pradana, 2012, p.226) say that all human endeavours involve uncertainty and risk and that risk is more in the business sector compared to other sectors.

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Every business decision and entrepreneurial act is connected with risk and this applies to both the SMEs as well as the bigger firms. Effective management of risks is central to the performance of business enterprises. Madura (2008) argued that the main business of any business enterprise is to manage risks. Unlike large enterprises in the formal sector, a small enterprise is constrained by financial and other resources and greatly affected by Operational Risk. This inherent characteristic of SMEs makes it imperative that there should be a mechanism through which it may get support in different functions of business. It is therefore of interest to academics, practitioners, and industry professionals' to determine what factors contribute to the success of a small business. This raises concern on their general performance and therefore, their management. Risk management practices are generally intended to protect and add value to the enterprises and its stakeholders through supporting the business's objectives and reducing business mortality rate.

With the surge in new SMEs and the existence of Operational Risk in all spheres of life, they have to survive and enhance value in such environment. In recent times, there has been an extensive amount of literary research devoted to Operational Risk Management in SMEs. Nevertheless, the bulk of such research has tended to concentrate on SMEs in developed countries and very limited studies have provided such research on SMEs in Africa (Carter and Jones- Evans, 2008). Janney and Dessy (2006) noted that SMEs are far away from adopting a positive approach towards risk management due to limitations such as inadequate infrastructure, limited managerial and technical expertise, and lack of financial and intellectual resources to generate substantial technological developments and change, weak information networks to locate and recognize information and knowledge that is especially relevant to them, and low or even no investment in research and development.

According to Matthews and Scott (as cited by Pradana, 2012. P.229), many SMEs have no explicit image of risk and their risk management is often not well structured nor systematic or standardized. Henschel (2009), submits that there are very few sources in the literature on risk management as applied by SMEs. This implies that risk management in SMEs and more so Operational Risk is still in an early phase of development and that no standard for SMEs has yet become established which would describe how a comprehensive risk management should appear. Pursuant to Chivara and Karen (2013, p. 187), it has only been a few years since the management literature started to show an interest in applying Risk management in SMEs.

For this reason, many areas are still understudied thereby presenting a need for further research in the areas of risk management and Operational Risk. Empirical studies have further shown that the attitudes of SMEs toward Operational Risk and their risk assessment differs significantly from that of large enterprises due to availability of information that is lacking in the SMEs sectors. The purpose of this study is to provide insights into the ORM practices and the performance of SMEs that are ill- understood.

Despite broad recognition of the benefits of Operational Risk Management (ORM), there is limited empirical evidence on whether ORM as a formalized activity has been implemented in SMEs. The failure rate of SMEs in Kenya is very high despite their attraction to many individuals (GoK, 2005). Similarly, Hallberg (2000) estimated that only one in five businesses survive to their fifth anniversary and a mere one in ten make it to their tenth. This fact raises concern on their general performance and therefore, their management. Furthermore, it is expected that by the year 2030, Kenya would have transformed into a newly industrialized nation. If the country has to make this leap, then the SMEs are expected to play a key role in this transformation. This can be achieved by managing Operational Risk and minimizing the failure rate characterizing the sector if not completely eliminated. This article seeks to investigate the effect of ORM practices on the performance of SMEs in Kakamega County. It is hoped that the knowledge gained from this study could serve as a basis for planning and improving the SME subsector.

The study is also significant in that the information obtained would help the SMEs adopt sound ORM practices that reduces exposure to Operational Risks. The study also comes up with findings that would inform the SMEs on the critical areas to consider when employing ORM practices. The findings which reveal the critical management factors affecting the performance of Small and Medium Enterprises in Kenya may also be useful to donors who are interested in funding SME development projects as well as serve as points of reference for further research in ORM practices. Further, the study also contributes to the existing body of knowledge and also enhances knowledge on management of Operational Risk.

The Concepts of Risk and Operational Risk

Risk is any issue that can impact the objectives of a business entity and the potentiality that both expected and unexpected events may have adverse impact on the capital and earnings. Gupta, (2004), refers to risk as the possibility of deviation from the standard path. Raz and Hillson (2005, p.54) defines Operational Risk as the risk associated with losses that result from inefficiencies or non-conformances within the operational processes of an organization including quality, environmental, occupational health and safety risks, breakdowns or failures relating to people, internal processes, technology or the consequences of external events just to name but a few. Basel Committee on Banking Supervision II (2006) defines Operational Risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Noteworthy sources of Operational Risk are interruption in business processes, fire, chemicals or other environmental hazards, poor workplace safety, inadequate maintenances of equipment and production facilities, employee incompetence, health problems and corruption. Jorion (as cited in Kristian, 2011, p.91) portends that if risks are mismanaged, then the firm may suffer significant commercial damage or even bankruptcy.

SMEs operate in the same environment as their larger counterparts, but without the associated benefits such as adequate capital and extended Human resources of the larger organizations (Yolande and Watkins, 2012). SMEs encounter increasing competitive pressure fuelled by globalization, legislation and the relaxing of trade barriers, as well as an increase in the market expansion due to emerging technologies and innovation. SMEs often flourish on their adaptability and agility such as their close proximity to customers, their openness towards new ways of working, and their risk taking approach, but many are susceptible to major external shocks as argued by Laforet and Tann (as cited in Yolande and Watkins, 2012,pg. 6325).

SME owner- managers need to escalate the importance of risk identification and minimization in their organizations or they can suffer catastrophic consequences if they are ill prepared for the outcome of a possible risk. This entails that entrepreneurs in SMEs need to be conversant with risk identification and analysis to manage risks from a diverse range of sources. By incorporating risk management into SMEs operations, SMEs are better equipped to exploit their resources, thereby enabling organizations to transform an expenditure activity into an

activity that can yield a positive return (Banham as cited in Yolande and Watkins, 2012, pg. 6325)

Operational Risk Management Practices

Halman and Weiden, (as cited in Pradana, 2012, p.228) define Risk management as a continuous monitored integrated formal process for defining objectives, identifying sources of uncertainty, analysing uncertainties and formulating managerial resources to produce an acceptable balance between risk and opportunities. Head (as cited in Tajudeen and Francis, 2013) defines Risk Management as the process of planning, organizing, directing, and controlling resources to achieve given objectives when good or bad events are possible. The main objective of risk management is therefore to ensure that an organization is not prevented from achieving its primary objectives as a result of losses that might arise from its operations.

According to Chivara and Karen (2013, p.194), risk management for SMEs remains a "spot" subject, despite their wide diffusion and importance from an economic and social perspective, and the fact that they are structurally weaker and exposed to the danger of failure when facing unexpected risks such as Operational Risk. Emphasis is laid upon the need for a new research stream that studies the implementation of risk management in the context of SMEs because knowledge of the issues of risk in SMEs is inadequate and practical and academic studies are still limited. In the debate among managers, there seems to be a fruitful interest in risk management applied to SMEs. However this is not accompanied by a substantial body of studies in the literature hence a clear need for a study in the area of Operational Risk management in SMEs. Risk management practices that have the possibility of having an effect on the performance of SMEs are henceforth discussed below.

Regulatory Compliance

Regulatory Compliance involves the act of ensuring that an organization complies with relevant laws and regulations (or managing the penalty imposed if caught against the cost of implementing controls). This is a Herculean task, particularly for SMEs to ensure that common services are complying with the number of standards, laws, and regulations. Violating such regulations can result in significant fines, sanctions, and lost business opportunities (Clive, 2010).

Legislative compliance is an area where organizations need to continuously monitor changes to minimize their exposure to losses. Legislation is an area that constantly changes and it is possible for an organization to have procedures and contracts in place that are out of date. For example, health and safety legislation may change and impose new standards of managing workplace risks. If the new standards are not implemented in an organization and a workplace accident occurs, then significant penalties may be imposed on the organization and its management (Simon, 2001). In today's dynamic multi-regulatory environment with its heightened level of accountability, the stakes of non-compliance are higher than ever for SMEs.

It is essential that they assure that their compliance and inspection procedures are thorough and well documented to withstand the intense scrutiny of not only the Commission but also of the public, which is increasingly litigious (Lawrence, 2003). Procedures to comply with regulations such as registration, taxation, health and environmental regulations and procedures necessary to benefit from government incentives are difficult to comply with partly because of bureaucratic requirements. While large firms have staff specialized in these matters, such requirements represent an enormous burden for SMEs. Kenya is a good example of a variable regulatory and policy system that has been improved over the last few years. Past Studies have shown that, with the help of the Department for International Development, Kenya introduced a single business permit, which has drastically reduced the financial and transaction costs of operating a business. Since its implementation, Asmalesh, *et al*. (2001) envisaged that the number of SMEs being registered and allowed to do business in Kenya has gone up substantially but their demise is still high. To sum up, poor regulatory environments in Africa are characterized by the absence of laws and regulations for SME development; the complexity of such regulations, which substantially increases the transaction costs of SMEs, putting them at a disadvantage vis-à-vis larger national companies and foreign enterprises; and the lack of transparency in implementing SME support programs, which deliberately benefit other actors rather than the targeted SMEs could be one of the factors that has led to the high rate of demise.

Contingency Planning

According to the Merriam- Webster dictionary, a contingency is something (such as an emergency) that might happen. Contingency planning might actually be the most critical aspect of your overall strategic plan .In any estimate or project plan the estimators always include an item at the end of the estimate for contingencies. A contingency allowance is necessary because uncertainty exists in the estimating data and assumptions. The costs cannot be defined precisely when the estimates are made. In most African countries and in particular Kenya, many SMEs rarely keep funds for contingencies. With their high mortality rate, there is need to establish whether this could be one of the effects of not planning for contingenties and also find out if contingency planning has helped reduce Operational Risk. Henschel (as cited in Tajudeen and Francis, 2013,p. 82) affirms that a risk management System is necessary for SMEs because it is in the essential interest of the SME and that it will therefore help in the development of contingency plans to stop the erosion of organizational income and improve performance. Brahim (2013) opines that crisis management planning in the context of SMEs is less extensively researched despite a long established crisis management literature that only focuses on large enterprises hence the need to establish the same for SMEs.

Avoiding or reducing the cost of financial distress

The Basel Committee on Banking Supervision (2006) defines financial distress as a situation where a business has a 90 days overdue on credit agreement payments. Commercial banks often discriminate against SMEs because they are considered high risk clients with little or no resources to provide collateral.

Pretorius and Shaw (as cited in Yolande and Watkins, 2012, p.6326) posit that South African bankers are less inclined to finance SMEs due to their perceived high level of risk and a weak expected return. Instead, Banks establish prohibitive collateral conditions that most SMEs cannot afford. SMEs access to working capital in the form of short-term loans and overdraft facilities is therefore highly limited. SMEs therefore operate in the same environment as their larger counterparts, but without the associated benefits such as adequate capital and extended human resource of larger organizations according to Yolande and Watkins (2012, p.6324). Countries such as Kenya and Uganda appear to have a good network of NGOs providing short-term funding for SMEs according to Asmalesh *et al*. (2001). Previous researches point out that the main pitfall of these schemes is the limited size of the loans, which does not seem to have a big impact on SMEs capability building and competitiveness. Nevertheless, NGO micro-finance programs are increasingly being used at least for short-term needs that are rarely served by commercial and development banks hence access to finance remains a major problem for SMEs and this greatly increases the risk of financial distress. Most entrepreneurs have to rely entirely on their own savings and money borrowed from friends and relatives.

Insurance

Insurance has always been used to mitigate various kinds of Operational Risk, such as the risk of fire (damage to physical assets). Insurance companies have been lobbying regulators to accept the idea of replacing (at least in part) regulatory capital with insurance. Currently, a wide variety of insurance products (policies) are available to SMEs. There are, however, doubts about the role of insurance in Operational Risk management.
Cruz (2003) identifies pitfalls with insurance for Operational Risk, including the following: the limiting conditions and exclusion clauses, which may impede payment in the event of failure; delays in payment, which could result in serious damage to the claimant; and the difficulty of determining the true economic value of insurance in the absence of sufficient and appropriate data, a characteristic of SMEs.

The Basel Committee on Banking Supervision II (2006) has expressed doubts about the effectiveness of insurance products, stating that "it is clear that the market for insurance of Operational Risk is still developing". And although Basel allows other businesses like banks using the American Marketing Association to take account of the risk mitigating impact of insurance in their regulatory capital calculations, some strict conditions must be satisfied. In general, regulators have a problem with the proposition that regulatory capital can be replaced (at least partially) with insurance. This is mainly because regulators are sceptical about the feasibility of immediate pay outs (which is not what insurance companies are known for). There is also fear about the ability of the insurers to get off the hook (completely or partially) through some dubious clauses in the insurance policy. Taking insurance, is not risk transfer but rather (external) risk financing through the insurance company as an alternative to financing it through capital and reserves (Wafula, 2004). Risks are realities and every shopper or commercial investor must contend with them.

One way to protect against economic loss is an insurance policy. Insurance Companies do not prevent losses. They offer the next best thing, which is financial protection against the consequences of loss. Azende (2012, p.9) envisaged that SMEs appear more risky hence not attractive to insurance investors. The list of risks facing SMEs is endless because it is one sector where entry and exit is uncontrollable. Very few SMEs have insured their businesses against risk therefore this calls for a study that will try to establish whether there is a high correlation between business failure and lack of insurance in most SMEs.

Performance indicators

Longevity or continuance in operation

Business Continuity according to Ian (2011, p.8) means maintaining the uninterrupted availability of all key business resources required to support essential Operations and it is therefore one of the indicators of good performance of a business enterprise. The success of a small business can be measured in various ways. However, success is predominantly measured in terms of continuance in operation or longevity and financial performance including profitability, sales, and market share. Wasilczuks (2000) notes that small business growth and success measurement is difficult to assess and can be measured either objectively or subjectively.

Solvency

Solvency is strictly linked to liquidity because a liquid business is also solvent. Liquidity implies the ability to meet liabilities as they mature, depending upon the nature and composition of assets and the estimation of liabilities (Fabiano.*et al*. 2001, p.76). Solvency involves the ability of an enterprise to meet future payments to creditors when assets value exceeds liabilities value. Therefore, solvency is linked to the level of capital compared to technical reserves or total assets.

Enhanced firm value

Risk management in organizations has undergone a paradigm shift. It has moved from being "hazard type" to "strategic type". Risks are now not perceived as threats (adverse financial effects) but as potential opportunities. The focus of risk management has changed from all risks to critical risks. Recognition of risk management as a separate managerial function entails many advantages. Inclusion of risk management as a strategy in the general management function helps to enhance the value of an enterprise (Suranarayana, 2003). Jorion (2001) deduced that the success of organizations depends upon the risk management. Lam (2001) also supports the view that risk management reduces earning volatility, maximizes value for business owners and promotes job security and financial security in an organization.

Competitive advantage

To achieve values for business owners, a firm should achieve a competitive advantage over its rivals or competitors by adapting itself to the uncertain and risky business environment

(Byeong *et al*., 2004, p.65). As achieving competitive advantage has been recognized as the most single important goal of a firm (Porter, 1980), business owners have pondered why some organizations have been able to secure an advantageous competitive position while others have not. Without achieving competitive advantage, an enterprise will have few economic reasons for existing and finally will wither away or decline in performance and eventually cease operations. Managers face increasing challenges in implementing effective and efficient ORM strategies that will see them attain high market performance. It is therefore needful to try to establish the extent to which ORM practices affect the performance of SMEs in terms of enhancing a business's competitive advantage over its rivals.

METHODOLOGY

Study Area

The study was conducted in Kakamega town that is situated at latitude 0.28° North and longitude 34.75° East of Greenwich Meridian and at an elevation of 1524 meters above sea level (Google Earth map data, 2015). The practical considerations that dictated the choice of this Study area were that Kakamega County has Agriculture as the mainstay of the local economy with a majority of residents depending on it for their livelihoods. Kakamega town has seen a meteoric rise in the number of SMEs in the recent past because Agriculture has been threatened by the ever rising population hence dwindling of Agricultural land. This unfolding event has seen the establishment of SMEs as an alternative economic mainstay. It has been observed that majority of these SMEs do not grow and most survive for a short period of time, mostly, less than 5 years. There was therefore the need to find out whether or not owners of surviving SMEs employed Operational Risk Management practices and if so, the effect of these ORM Practices on their performance.

Data Collection Methods

This research relied as much as possible on the participant's view of the situation studied. For that reason, Qualitative data was collected on all variables that were studied i.e. the ORM practices and performance of SMEs. Data was collected from Primary sources (primary data) by the administration of a structured survey questionnaire because of its simplicity, its versatility and its low cost. The type of primary data that was collected for this study was basically opinion and attitude data designed on a Likert scale approach.

Analytical Framework

Pervez and Kjell (2007 p.188) state that the general multivariate regression model of a dependent variable Y on a set of k independent variables $X_1, X_2, \ldots, X_n$ is given by;

$$Y = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + \ldots + b_nX_n + \xi$$

Where: b_0 is the Y intercept of the regression surface; b_i are constants and; ξ is the error term. According to the regression equation, performance (PERF) was a function of insurance (INSU), contingency planning (CONTPL), avoiding financial distress (AVFID), and regulatory compliance (REGCOM). The function therefore became;

$$PERF = b_0 + b_1 (INSU) + b_2 (CONTPL) + b_3 (AVFID) + b_4 (REGCOM) + \xi$$

To test this model, each variable was established and tested individually using simple regression and then collectively using the multivariate regression model. An error term (ξ) in the multivariate regression model was used to test the effect of organizational factors on the relationship between the key study variables. Factor analysis and more specifically varimax was also used as a data reduction technique whose objective was to reduce variable complexity to 1 in the chosen factor solution. Andy, *et al*. (2011, p.113) deduces that multiple regression analysis allows us to incorporate nominal variables into the model, provided dummy variables are used after being coded. Multiple regression analysis is also a robust method of data analysis. This means that it works quite well even when certain assumptions have not been met. In practice, we could use ordinal variables in our regression analysis quite successfully (Andy *et al*., 2011 p.115) hence the choice of data analysis method because the data for this study was both nominal and ordinal. Moreover, previous studies have successfully used it.

RESULTS AND DISCUSSION

Table 1 shows the multiple regression analysis of the effect of ORM practices on the performance of SME's.

Using the regression results in replacing the values of beta in the equation:

$PERF = b_0 + b_1 (INSU) + b_2 (CONTPL) + b_3 (AVFID) + b_4(REGCOM) + \xi$, we have;

$$PERF = 1.054 + 0.56 (INSU) + 0.514 (CONTPL) + 0.627 (AVFID) + 0.494(REGCOM) + 0.65335$$

The null hypothesis stated that ORM practices have no effect on the performance of SMEs. We were to accept the null hypothesis if $\beta_i = 0$ or reject the null hypothesis if $\beta_i \neq 0$. From the results, b_1=0.56 ≠0, b_2=0.514≠0, b_3=0.627≠0 and b_4=0.494≠0. The study therefore rejected the null hypothesis.It was therefore concluded that ORM practices had a statistically positive linear effect on the performance of SME's. The significance of the overall goodness of fit as shown by R^2 of 0.3860 shows that the overall explanatory power of the model is 38.6 percent. The various ORM factors included in the model jointly accounted for about 38.6 percent of the variations in the performance of SMEs. The unexplained 61.4 percent of the variation can be attributed to the omitted variables like those of the organizational factors. The F- test statistic had a significance of zero meaning that the model does fit the data to an extent greater than we would expect to see by chance less than one time in a thousand.

In line with Clive (2010), violating regulations can result in significant fines, sanctions and lost business opportunities. Respondents of this study were in agreement with the above as seen in the results.

Table 1. Regression results of ORM practices on performance of SMEs

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.621[a]	.386	.362	.65335

Predictors: (Constant), INSU, CONTPL,AVFID,REGCOM

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	28.133	4	7.033	16.477	.000[b]
	Residual	44.821	105	.427		
	Total	72.955	109			

a. Dependent Variable: PERF
b. Predictors: (Constant), INSU, CONTPL,AVFID,REGCOM

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.054	.560		1.883	.009
	INSU	.324	.126	.560	2.571	.002
	CONTPL	.603	.114	.514	5.302	.000
	AVFID	.124	.077	.627	1.610	.003
	REGCOM	.317	.169	.494	1.879	.000

Dependent Variable: PERF

Significance level =0.05

Source: Research data, 2015.

Roberts (2009) revealed that many SMEs use an allowance of about 10 percent for contingencies. The study also agrees that contingency planning is one of the most critical aspect of the overall business strategic plan and that it allows for alternative courses of action when the primary plans that have been developed do not achieve the goals of the business. In consonance with Pretorius and Shaw (as cited in Yolande and Watkins, 2012 p. 6326), Commercial banks often discriminate against SMEs because they are considered high risk clients with little or no resources to provide collateral for loans. This study is also in agreement with the above because respondents cited lack of capital to be a strong constraint to business growth and also agreed that formal financial institutions perceive the high risks and transaction costs to be an impediment to lending to the SMEs leading to financial distress. Lack or inadequate capital was also cited as one of the reason for the frequent closures of businesses.

Respondents agreed that insurance will reduce the risk of loss resulting from Operational failures even though high insurance premiums discourage business owners from insuring their businesses against Operational Risk. Cruz (2003) argued that delays in payments could result in serious damage to the claimant and this is in agreement with the findings of the study. The study was partly in agreement with Brandts (2005) who doubted that insurance is an effective way of mitigating Operational Risk for instance, compensation was often subject to a range of limitations and exceptions. Specifically, he identified three problems (risks) with insurance: the payment uncertainty resulting from mismatches in the actual risk exposure and the insurance coverage; delayed payment, which may result in additional losses; and the problem of counterparty risk resulting from the possibility of default by the insurance company.

Also, Azende (2012, p.9) envisaged that SMEs appeared more risky compared to their larger counterparts hence not attractive to insurance investors. This is in agreement with the results of this study.

Policy implications

Based on the results, a number of policy decisions can be made for example; the Government should proactively engage in creating a conducive environment under which SMEs will operate in because there is a positive effect of regulatory compliance on the performance of SME's. Procedures to comply with regulations such as registration, taxation, health and environmental regulations and procedures necessary to benefit from government incentives are difficult to comply with partly because of bureaucratic requirements. While large firms have staff specialized in these matters, such requirements represent an enormous burden for SMEs and therefore the government should reduce the bureaucratic requirements that are an obstacle to regulatory compliance. There is a positive relationship between contingency planning and performance of SME's. It is therefore important that owners of SMEs be encouraged to have contingency plans whereby they will need to set aside some funds for any unforeseen circumstances that may jeopardize the day to day operations of their businesses.
The Government should also address the problem of unfair commercial laws that have increased transaction costs for SMEs (more than for larger firms). This has hampered their economic performance and competitiveness hence leading to financial distress and eventual collapse. That means that the government through the central bank of Kenya can regulate the interest rates charged by banks to SMEs and if possible encourage or compel financial institutions to offer affordable loans to SMEs by charging low interest rates on loans.

Banks should also offer startups a longer grace period and not insist on too much collateral in order to advance credit facilities. The Government should also make it mandatory for owners of SMEs to insure their businesses as a way of mitigating the risks likely to be faced. The government can do

this by ensuring that insurance companies have insurance premium packages that are tailor made for SMEs and that are affordable. This will ensure that SMEs do not collapse when faced with risks that can be mitigated by insurance. The Government can also ensure that insurance companies don't get off the hook through dubious clauses in the insurance policies that could lead to serious damage to the claimant and also address the problem of delays in payment.

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