

Research article

Determinants of the extent to which the operational and running cost affect competitive performance of textile SMEs in Kenya

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Abstract

Small and Medium sized entrepreneurial Enterprises (SMEs) play an important role in economic development of many countries in the world. This is because they have potential of employing many people in environments where formal and full wage employment may be scarce or unavailable. SMEs within EPZ are entrepreneurial as they apply creativity and innovation to add value so as meet the needs of their clientele. In Kenya, textile SMEs in Export Processing Zones (EPZ) did well in generating job opportunities to many Kenyans since inception in 2000, contributing 18% of Gross Domestic Product to the national economy. There is limited information on the factors that determine their performance.

The purpose of this research was to establish the determinants of the extent to which the operational and running cost affect competitive performance of textile SMEs in Kenya. This research was conducted using descriptive survey. It involved both qualitative and quantitative designs. The design was useful in gaining insights into what goes on among textile SMEs within the Export Processing Zones and therefore provide holistic description of their competitive performance as this will allow the description of the textile SMEs within the Export Processing Zones and hence providing insights of their performance. Given the small number of firms operating these businesses within the Export Processing Zones, an adjusted sample size from small target population was used to select a representative sample of the study using Saunders & Thornhiel formula.

This study used interview for owners (IO) and employees in addition to questionnaire for managers (QM) for

data collection to achieve the objectives of this study. A pilot test was carried out to test the instruments for corrective purposes, adjustments, validity and reliability. The statistical analyses were facilitated by the use of Statistical Package for Social Sciences (SPSS). The estimate results on average of $R^2 = 72.4\%$ and adjusted average value of $R^2 = 55.7\%$ indicated that all the independent variables tested were significant determinants of competitive performance of EPZ textile SMEs in Kenya. The study found that credit availability and affordability is essential for their competitive performance, growth and continued profitability. Equally are backward/ local linkages of raw materials, constant sub sector specific policy and regulations and reduced operational costs are critical for their success. The study therefore recommends that quick interventions by the relevant authorities to address the operational and running cost affect to ensure competitive performance of textile SMEs in Kenya. **Copyright © FEARJ, all rights reserved.**

Key words: Small and Medium Enterprises, Export Processing Zones, Internationally, Performance, Competitive Performance, Policy and Regulatory Framework.

Introduction

Entrepreneurship is generally conceived as enterprise development in which the main goal is to create and manage own business. The entrepreneurial process involved in business creation is based on the entrepreneur's knowledge, skills and attitudes, which can initiate innovation, new enterprise and employment through renewal of trade and industry and new forms of organizations. The entrepreneurial businesses may be created in Small or Medium sized businesses and is found in all sectors of economy such as trade, manufacturing, tourism, clothing and textile and other sectors. Thus these businesses have come to be known popularly as Small and Medium Enterprises (SMEs). This study focused on textile SMEs within the EPZ in Kenya.

SMEs are key generators of local employment opportunities and enhance the use of local and appropriate technologies thus conserving scarce capital resources; and help prevent migration of young people from rural areas to urban centers (Gibb, 1988, Matlay 2005 and World Bank, 2011) looking for employment. It is very difficult for textile industries in Kenya to compete favourably with similar industries in other countries because of increased cost of production locally and high costs of raw materials unless they are highly subsidized and operate within some protected zones such as the EPZs (USSA, 2009). This seem to offer entrepreneurs who invest in these businesses some cushion and incentive to continue in these businesses. However, there is no study that has been done to establish their competitive performance. The purpose of this research was to establish the determinants of the extent to which the operational and running cost affect competitive performance of textile SMEs in Kenya

Unless strategic measures are taken, the textile/apparel SMEs will cease to exist. To be able to play an optimal role, the SME sub sector needs to grow and expand. This growth and expansion is threatened by stiff competition and globalization which the SMEs especially in the garment sector seem not prepared to meet. According to Republic of Kenya (2007), Economic Review, the SMEs in garment businesses recorded mixed performance in 2006 with the total sales increasing by 4.4 %. The businesses also have been facing additional challenges since the AGOA Quotas ended in 2005 although now renewed to 2015. Furthermore, direct employment of Kenyans in EPZ declined by 3.6% in 2006 to stand at 36,667 persons (Republic of Kenya, 2007). Much of these jobs were generated by garment/apparel enterprises with a total of 30, 813 or 86.7% of the total employment in EPZ.

The performance of SMEs within the EPZ in the era of liberalization in terms of exports has decreased according to Economic Survey (2007). The SMEs in garment recorded a mixed performance in 2006 with total sales increasing by 4.4% while total imports declined by 5.0 %. This implies that the programme faced several challenges and key among them is increased competition and high cost of production when AGOA quota ended in 2005. There is need for more inquiry into textile SMEs sub sector to ensure growth and survival to a vibrant business in Kenya in the era of globalization and stiff competition. This was the gist of this study.

Statement of the problem

There is a gloomy picture on the future of these businesses in Kenya despite the support the textile SMEs have been getting from the government (Republic of Kenya, 2007). The AGOA initiative supported textile SMEs within the EPZ. Through this arrangement, these SMEs firms would benefit from tax exemptions, waivers of industry regulations and exemptions from imports and exports duties to enhance their competitiveness and

growth (EAC Report, 2009). However, these SMEs are seemingly facing the challenges of competitive performance and effects of internationalization despite the support from the government. (McCormick & Kinyanjui, 2003). There is little information to explain causes of these challenges. According to the Kenya Vision 2030, there is low investment and the overall lack of competitiveness by textile SMEs especially those within the EPZ in Kenya. Their lack of competitiveness has seemingly reduced their performance drastically (McCormick, 2009). The reduction in the number of workers in the textile firms over the last few years has resulted in these firms scaling down and others shutting down their operations while others shifted to other countries. This has resulted in massive unemployment, loss of income and revenue thus contributing to economic decline in the country brought about by among others operational and running costs (Evelyn, 2005 and EPZ Performance Report, 2009 and 2010).

Research Questions

- a. To what extent do operational and running costs affect competitive performance of textile SMEs in Kenya internationally?
- b. What recommendations are necessary for textile SMEs in Kenya to enhance their competitiveness in the global market?

Literature Review

The Theoretical Framework for this study has been informed by Literature findings, gaps and indicators in the past studies in this area and gaps identified in Literature review. The theoretical development of entrepreneurship has its foundations in many disciplines such as sociology, psychology and economics. This makes the entrepreneurship study require multi-disciplinary approach in order to appreciate its contributions to the economic development of any country (Kibas, 1995). The theories that are relevant to this study are now discussed in this section.

The economic dimension of entrepreneurship theory indicates that entrepreneurship theoretical competitive performance framework is founded in economics. The ideas of capital provision, risk bearing, creativity, innovation, growth and expansion, and profit making, all have a bearing to economics but entrepreneurs turn them around to enhance the entrepreneurial growth of their businesses. In Schumpeter's (Swedberg, 2007), ground-breaking theory of economics development and developed further as Business Cycles (1939), Schumpeter refers to an entrepreneur as innovator. In his argument, he introduces- "new combinations"- new products, new production methods, markets, sources of supply – shaking the economy out of its previous equilibrium. Thus, Schumpeter sees an entrepreneur as a necessary innovator and risk bearer. Entrepreneurs through their innovation and creativity can enhance competition and bring about successful performance in their businesses.

Kirzner (1982), just like Schumpeter, argues that, an entrepreneur should be able to notice the unnoticed business opportunities. He asserts that these opportunities exist because of the existing un-coordinated non-equilibrium state in which previously unappreciated demands are not yet satisfied or not yet fully exploited. The action of an entrepreneur is to coordinate them for better growth and performance. The Kirznerian entrepreneur, like the Schumpeterian entrepreneur changes the future from what it would have been in his/her absence to better state. However, Penrose (1959) mentions a number of limitations that would limit a good performance of an enterprise. These include: Uncertainty of the life of the business, the managerial abilities, the availability and sustenance of the market. When these are catered for, an enterprise should be able to perform competitively well both locally and internationally.

Kirzner (1973 and 1979), again describes competition among enterprises as a discovery process. He argues that the source of entrepreneurial profit is superior foresight- the discovery of something (new products, cost-saving technology) unknown to other market participants. In more typical case, he states that an entrepreneur is alert to a new product or superior production process and steps in to fill this market gap before others. This means then, for Kirzner, success of an entrepreneur does not only come from a well specified maximization problem, but from having some knowledge or insights that one else has and the entrepreneur maximizes on it competitively.

Research Methodology

This study used descriptive design of a mixed method consisting of both qualitative and quantitative approaches in which the researcher will use multi-stage selection of subjects. There were 30 apparel/textile businesses within and /or under the umbrella of EPZ in Kenya from which the sample size was selected. The target population of this study was small consisting of 30 textile SME enterprises therefore conventional determination of the sample size of the large targets was used. The study used the adjusted sample size from small target population, hence the formula by Saunders & Thornhiel (2009) was used. Since each business had a manager and a director, every purposively selected textile business had each of their manager and director selected. The researcher sampled 380 employees out of approximately 30,000 using systematic random sampling procedure.

The study used interview guide for the directors, questionnaire for managers and questionnaire for employees as data collecting instruments. The pilot test was also done to refine the questionnaire so that respondents had no problems in answering the questions and that there were no problems in recording data. The researcher cleaned and coded the data using Statistical Package for Social Sciences (SPSS) out of which graphs and tables were drawn for analysis and discussion. Regression analysis was used to test research hypothesis.

Findings and Discussions

Operational and Running costs

This study has established that operational and running costs on production determine competitive performance of EPZ textile SMEs in Kenya and are higher compared with its close competitors such as South Africa and China. The study has also found that the cost of electricity in Kenya is four times the cost in South Africa and more than thrice in China. It is even made worse by power outages/rationing and fluctuations which have lead to reduced output and damage of equipment of the textile SMEs in Kenya. The statements in Table 1 are about the cost of textile on SMEs in textile enterprises at EPZ. The statements indicate the extent to which production costs affects competitive performance of SMEs of textile businesses in EPZ. Their responses are summarized in Table 1.

Table 1: Operational and Running costs

OPERATION COSTS		S.A	A	S.D	A	N	TOTAL
1	Custom prohibits low cost import	10.2	21.4	30.5	20	17.9	100
2	High cost of imports negative effect	10.7	22.5	10.7	25.9	30.2	100
3	Adverse macroeconomics environs	10.7	39.9	21.4	0	28	100
4	Lack of Govt. operating outside EPZ	10.8	0	35.6	25	28.6	100
5	Inadequate supply of trained labour	20.5	29	0	20.4	30.1	100
6	Poor infrastructural network	7.1	47.3	25.3	10.1	10.2	100

From this table 1, 33.2% of the respondents agreed that the cost of imported raw materials impacted negatively on their competitive performance while 10.7% strongly agreed with this fact. The respondents, who in some firms are directors and managers as well, also indicated other factors whose costs affected their competitive performance such as poor infrastructural networks and cost of electricity 47.3 % inadequate supply of trained labour 29 %) adverse macro economies environment in whose cost of capital and fiscal policies reduce their international competitiveness (78.6%). These facts are supported by McCormick (1991) who affirmed that the cost of production among garments Small and Medium Enterprises is one of the major impediments to competitiveness and growth. These findings are also supported by EPZ Performance Report (2010 and 2011) which concludes that the cost of production within the national economy besides international scene constraints needs to be addressed.

Performance of EPZ textile SMEs in Kenya

The study has established that although a lot remains to be done for better competitiveness by EPZ textile SMEs, these businesses are fairly doing well. In addition, the study reveals some gaps that these businesses need to address to boost their sales turnover. These include, better pricing of their products, quick responses to their customers, enhanced quality and customer retention and more exposure through trade fairs and exhibitions for greater networking. The statements in Table 2 are about the performance of textile on SMEs in textile enterprises at EPZ. The statements indicate the extent to which performance affects competitive performance of SMEs of textile businesses in EPZ in relation to the vision 2030. The respondents were asked the extent to which they strongly agreed or not agreed to the statements relating to various factors that may affect their competitive performance at EPZ. Their responses are summarized in Table 2.

Table 2: Performance of EPZ textile SMEs in Kenya

To what extent do you agree with the following performance statements (SA=Strongly Agree, A= Agree, D= Disagree, SD=Strongly Disagree, N= None of the above							
		SA	A	D	SD	N	Total
		%	%	%	%	%	%
1.	The quality of our textile products are high and standardized						
2.	The pricing is competitively good	28.6	71.4				100.0
3.	We are flexible and responsive to our customers requirements	28.6	64.3	7.1			100.0
4.	We observe punctuality in delivering to our customers	17.9	71.4	10.7			100.0
5.	We participate in local shows and exhibitions	17.9	60.7	21.4			100.0
6.	We participate in international trade fairs shows and exhibitions	14.3	28.6	39.3	17.9		100.0
7.	Our sales turn over are very good	21.4	46.4	32.1			100.0
8.	Decisions and activities in our organization are customer-based.		25.0	57.1		10.7	100.0
9.	Departments within the organization are able to work together effectively and facilitate responses to customer needs		50.0	39.3		10.7	100.0
10.	Our business can respond to customer needs in a rapid manner.	7.1	82.1	10.7			100.0
11.	Our sales turn over are very moderate	21.4	78.6				100.0
12.	Our profit and sales goals have been achieved through product quality and customer retention		57.1	32.1	10.7		100.0
13.	Our sales turn over are very poor	14.3	39.3	35.7	10.7		100.0

The table 2 shows the respondents rating competitive performance issues as they affect their competitive performance. Most respondents (82%) said that although they responded to customers in a rapid manner and their pricing (71.4%) is competitively good, their sales turnover was rated as 46.4 percent with only 24.1% rating it as very good. This shows their competitive performance is not very good and therefore needs improvement. This concurs very well with what World Bank studies (World Bank, 2011) stated that the Sub-Saharan African countries including Kenya adopted Economic zones only recently with most programs in the 1990s. The report says that consensus from previous research is that African zones have generally underperformed, with significance exception of those in Mauritius, and partial exception of those in Kenya, Madagascar and Lesotho.

On participation in the international trade fairs and exhibitions there was strange reactions from the respondents with only 14.3 percent strongly agreeing on their participation in trade fairs and exhibitions, 62.2 percent disagreeing and yet over 80 percent participate in local exhibitions. This shows how most entrepreneurs in this sub-sector seem to be ignorant about the importance of networking and linkages which are important in improving their sales turnover through their participation in trade fairs and exhibitions. Thus there is a need to create more awareness on the importance of such events. An entrepreneur view of competition in business is

healthy as it brings about sharpness in time management, quality control, flexibility and innovation which are necessary for business survival. Through this way entrepreneurs are motivated to invest in Small and Medium Enterprises for sustainable livelihood, poverty alleviation and job creation in a competitive performance and success. The factors expressed by many of them mainly touched on pricing of their products, flexibility and responsiveness to their customers requirements. In addition, they also mentioned quality and customer retention, sales turnover, coordination and organization, profit and sales goals and their participation in trade fairs and exhibitions and their contributions towards the Kenya Vision 2030.

Views on Performance by Employees

This study has established from employees that although the issues they highlighted had lower scores according to their responses, they are significant in terms of performance. This includes continuous retraining and upgrading on relevant emerging skills, training on job in specifics skills as may be required, need for rapid respond to customers' needs, involvement of workers in decisions that affect their core duties, more exposure to both local and international trade fairs and exhibitions, improved safety regulations of workers and observation of labour laws that impinge on workers' rights. The study observes that when these issues are effectively addressed will greatly improve on the working morale of workers thus their retention and productivity. This is supported by earlier studies and reports by Kobonyo (Kobonyo, 1998, Lipsey, 2007, USSA, 2009 and McCormick et al, 2009). A good performance of EPZ textile small and medium enterprises, their growth and competitiveness is the ultimate goal of the investors. One of the hypotheses of this study was that adequate and supportive policy among other factors would enhance motivation of employees raising their productivity. Towards this end, the employees were asked their opinion on a number of statements pertaining their performance at EPZ in Kenya. Their responses are summarized in Table 3.

Table 3: Views on Performance by Employees.

	To what extent do you agree with the following performance statements (SA=Strongly Agree, A= Agree, D= Disagree, SD=Strongly Disagree, N= None of the above	Employee Responses				
		SA %	A %	D %	SD %	N %
1.	The quality of our textile products are high and standardized	30.6	62.3	4.5	.8	1.8
2	We are flexible, timely and responsive to our customers requirements	34.8	53.7	8.2	1.4	1.9
3	We observe punctuality in delivering to our customers	17.3	40.7	18.1	18.9	5.1
4	We participate in local shows and exhibitions	16.3	38.8	17.9	17.7	8.3
5	We participate in international trade fairs shows and exhibitions	19.7	54.4	16.7	7.5	1.6
6	Decisions and activities in our organization are customer-based.	19.1	49.6	19.9	9.8	1.6
7	We are always involved in business decision making with regard to our core work	19.1	49.2	20.2	9.8	1.6
8	We are not always involved in business decision making with regard to our core work	23.3	53.8	16.4	4.5	1.9
9	Departments within our organization are able to work together effectively and facilitate responses to customer needs	23.7	55.0	14.5	4.5	2.4
10	We coordinate very well with our supervisors for effective	24.3	52.4	17.5	4.0	1.9

	delivery of our products					
11	We are always ready to respond to our customers needs in a rapid manner.	15.8	39.7	26.3	13.7	4.5
12	We are trained very well on our jobs	14.6	42.4	26.0	13.0	4.0
13	We are retrained on emerging skills to improve our performance and quality in our production	21.2	56.9	15.6	6.1	.3

The study established various reactions from the respondents. According to this table, majority (92%) of respondents did not have a problem in producing quality and standardized products as required by their clients. 87% also agreed that they are flexible and timely in responding to their customers needs with 78% agreeing with the statement that they are well coordinated to work efficiently to meet their customers' needs. However, a significant number (68%) said they are not involved by the management in decisions with regard to their core work. 39% said they are not trained well on their jobs. Although the table shows that the employees are fairly doing well with existing policy, pertaining their performance, the management will require addressing issues raised by the employees in order to improve on their quality, timeliness in delivery of their products, improve their motivation in work and reduce overworking. This will overall improve the competitive performance.

The study shows that there is significant relationship between operational and running costs on performance for small and medium enterprise in Kenya. It is therefore important for this costs to be addressed for them to perform better in relation to others in the region and internationally. There is significant relationship between EPZ's and competitive performance for small and medium enterprise in textile internationally. Thus availability of cheap local raw materials for textile SME's in Kenya will enable them to do better competitively.

Conclusions

From the findings and discussions afore mentioned, it can be concluded as follows:

Operational Costs on performance

The regression model in this study was used to test the hypothesis which show that there is a linear relationship between dependent variable (Competitive performance) and the Independent variable (Operational and running cost). This is shown by the R square which is 0.932 or 93.2%. The adjusted R which is a good measure of fit explains that holding all other factors constant, operational and running costs explains 0.965 or 96.5% of all the variations in the changes associated with performance in the SME's. Since there is a positive correlation between the independent and dependent variables, the correlation is significant and thus the null hypothesis H_0 : There is no significant relationship between operational cost and competitive performance for small and medium enterprise in textile internationally, is rejected and an alternative hypothesis is formulated. H_1 : There is significant relationship between operation cost and competitive performance for small and medium enterprise in textile internationally.

Research Questions and Hypothesis

The researcher had five questions and five hypotheses which were asked as follows. The research posed on how credit accessibility, local cotton production, policy, internationalization and cost affected competitive performance of textile SMEs of EPZ in Kenya. The hypotheses were posed as follows:

H_0 : There is no significant relationship between operation and running costs and competitive performance of textile Small and Medium Enterprises in Kenya internationally. There is no significant relationship between operational cost and competitive performance for small and medium enterprise in textile internationally, is rejected and an alternative hypothesis is formulated. H_1 : There is significant relationship between operation cost and competitive performance for small and medium enterprise in textile internationally.

The study concludes that in order to enhance EPZ textile SMEs competitive performance, there is need to improve or remove barriers on imported textile raw materials as these impact negatively on their competitive performance and profitability. There is need to enhance the existing infrastructural networks and cost of electricity to improve these SMEs profitability. There is a strong need to re-focus on provision trained labour for these SMEs to enhance the parity and timely provision of services. There is also need to address adverse macro economics environment to reduce the cost of capital and fiscal policies and thus enhancing their international competitiveness.

Recommendations

Operational and Running Cost

- i. With regard to the cost of production, the study recommends removal of barriers on production cost experienced by EPZ textile SMEs for example cost of power, cost of transportation, inefficient port operations, and high wage rates and so on in comparison with the main competitors, for them to enjoy competitive performance and also promote foreign investments.
- ii. The study too recommends revival of local cotton production to enhance cheap supply of local textile raw materials for these SMEs as an alternative to expensive textile raw materials imports which will also save the country's foreign exchange.

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