FIRM- RESOURCES AS ENTREPRENEURIAL DETERMINANT AND PERFORMANCE OF MANUFACTURING SMALL AND MEDIUM (SMES) FOREIGN FIRMS INVESTING IN KENYA

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Abstract: *Internationalization is a strategy for achieving firm growth and for generating wealth by means of expansion into the new markets. The purpose of this paper was to examine the entrepreneurial firm resources and their effects on foreign small medium enterprises within the manufacturing sector in Kenya. The study is a descriptive survey that sought to explore the phenomenon foreign direct investment (FDI) among SMEs. It was conducted in Kenya within the manufacturing sector. The population of the study was drawn from the Export Process Zones within the country through a combination of stratified sampling and purposive sampling. Data was collected by use of questionnaires that were administered to managers of the firm that qualified to form the sample. Both qualitative and quantitative data was collected. Qualitative data was analysed through descriptive statistics that were used to analyse all characteristics of the firm variables so as to appropriately describe and summarise the data.*

The resources considered in this study included technological, human, financial and organisational resources. Results show that financial and technology resources are significant and positively related to performance. The study recommends that corresponding inputs should be increased for firms in order to pave way for further internationalization.

***Keywords**: Firm, firm-resources, performance, small and medium enterprises, Entrepreneurial*

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1.0 BACKGROUND

An organizational resource refers to a firms internal reporting controlling and coordinating systems as well as relations with other firms in the environment. Organizational resources allow the firm to interact, to compete in the international market with less bonded constraints. Organizational resources also play a proactive role in promoting FDI growth. A number of researchers have suggested that firm's internal relationships could have a great impact on its performance (Knight and Kavusgil, 1996). From an external point of view, good relationship with business partners such as suppliers, distributors and customers are strongly linked to performance of the focal company. The firm- resources that are essential to SME performance include technology resources, human resources and financial resources. SME performance in FDI is influenced by the strategies and resources brought to bear within a particular operating environment. Firm resources are defined as assets, processes and knowledge that allow managers to design and implement efficient and effective strategies (Zeng, 2007). Empirical studies have shown FDI firms often transfer technology and process innovation to their subsidiaries in foreign markets, leading to superior subsidiary performance because such transfer of technology allow subsidiaries to offer innovative products and quality services in the host country.

Financial resources are essential to FDI as they give firms a greater degree of freedom to contemplate wide ranging foreign expansion possibilities without necessarily compromising among opportunities and make expansion process smoother and less problematic. Thus failing to maintain a sufficient level of financial sources may lead a firm's international presence to lag behind rivals in the race of pursuing global leadership. However, financial resources possessed by a firm are derived from various sources, which relates to desperate cost concern and required-to-meet obligations for deploying the resources. As a result, the firm is required to synchronize its pace of global expansion with the expectation of different resource providers.

1.1 The objective: To determine the entrepreneurial firm-resources that foreign entrepreneurs possess that influence their performance in Kenya.

1.2 The Question: What are the entrepreneurial firm resources that are possessed by the foreign manufacturing SMEs investing in Kenya?

2.0 LITERATURE

2.1 SME Development and Foreign Direct Investment

Traditionally, FDI has been seen to be the preserve of large firms, both in developed and developing countries. However, there is growing evidence of changes in patterns of foreign direct investment, involving a wider range of source and destination countries and the increasing involvement of small and medium(SMEs) as foreign investors, as well as larger firms and MNEs. Unfortunately, most official investment reports do not separately identify FDI activity by the size of the investing firm. Nevertheless, there is evidence that a growing number of medium sized firms, in particular, are internationalising their operations as a strategic response to increasing competitive pressure. In this context, internationalisation represents a means of reducing costs, as well as of opening up new market opportunities, thereby enabling them to combine greater flexibility with cost reduction (Majochi and Zuchella, 2003). This reflects the fact that globalisation is not exclusively a multinational or large firm issue, as a growing number of SMEs are looking to expand their markets internationally.

In general, SME internationalisation is greater in smaller, open economies and less in larger, more self-contained economies, although there are exceptions. One of the best examples is Italy, where 70% of exports are contributed by SMEs (OECD, 1997). In addition, supply chains in sectors such as 'high-tech' and component manufacturing are becoming increasingly global in character, contributing to the development of new business opportunities for SMEs as potential suppliers world-wide, and opportunities for local SMEs in developing countries as second or third tier suppliers to main contractors.

One reason why the growing involvement of SMEs in FDI is important is because there is evidence to suggest that FDI by SMEs has some distinctive characteristics in comparison with FDI by larger firms, with potential positive implications for destination economies. For example, a survey of SMEs involved in FDI showed that more than half of their investment involved some form of partnership between the investing company and a domestic SME (UNCTAD, 1998). This is because it can be attractive for a foreign investing SME to work with an existing firm, rather than starting from scratch with a Greenfield investment, with positive implications for the local SME, in terms of spill over effects.

One of the few studies which focused on joint venture activity and co-operation between SMEs in mature market economies (Belgian) and firms in developing countries suggested that a SME in an industrialised country may represent a better partner for a SME in a developing or transition economy than a MNE (Davis*et al*., 2000). Essentially, this is because such a partnership is likely to represent a proportionately higher resource commitment in the case of a SME, which means that they are more likely to make efforts to ensure success. This suggests that a strategy of seeking to attract FDI undertaken by SMEs may be a rewarding one for transition and developing countries.

There is also the phenomenon of medium sized companies from mature market economies following larger firms investing abroad, as suppliers. Examples include medium- sized Finnish companies, which have internationalised following Nokia, setting up their own production units in countries such as China and Brazil as suppliers. 'Following major clients' was one of the motivating factors for investing overseas that emerged from a survey conducted among Taiwanese SMEs, alongside 'utilising local labour' and 'expanding markets (Kuo and Yang, 2003). Although the evidence base is limited, such trends offer potential opportunities, as well as threats, for local SMEs in transition and developing countries. On the one hand, opportunities may exist for some local SMEs as suppliers to these inward investing medium sized companies, which for a few may represent a stepping stone into wider markets. On the other hand, by encouraging their existing suppliers to become global players, MNEs can help to raise the entry barriers for local SMEs, as potential suppliers, at least in the short term.

Central and East European countries (CEECs) have themselves started to become sources of FDI. Although internationalisation through outward investment has a relatively short history in CEECs, it has been increasing, facilitated by the liberalisation of foreign exchange and capital flows. Although still modest in scale, it has been suggested that outward FDI by businesses in transition countries is qualitatively significant. Nevertheless, in most transition countries, it is currently limited to a small number of investors consisting mainly of national champions seeking to become regional multinationals in order to overcome the constraints of a small domestic market. The process represents a bottom-up response to internationalisation forces by businesses, rather than a macroeconomic, government inspired or supported strategy. At the same time, by international standards, multinationals from transition countries are medium or small in size, in comparison with leading firms within the sector (Svetlicik and Rojec, 2003).

2.2 Introduction of EPZs in Kenya

The EPZs program in Kenya was developed and implemented as part of the industrial sector adjustment program (ISAP) initiated in 1988 and aimed at restructuring the industrial sector in order to stimulate investments with deliberate orientation towards exports. The program was launched in response to the limitations presented by the import substitution industrialization strategy, which resulted in a decline in industrial investment and manufacturing output; poor export performance; and weak job creation. Before 1990, the reform program concentrated on reducing the anti-export bias of the overall policy and regulatory framework according to Export processing zones authority analytical reports.

The government with the support of the World Bank implemented the export development program (EDP) in 1990 to address infrastructural and institutional constraints to export production and marketing. The implementation of the EPZ constituted an integral part of the export development program. The export processing zones act (CAP 517) was enacted in 1990 “to provide for the establishment of export processing zones and the export processing zones authority to provide for the promotion and facilitation of export oriented investment and the development of enabling environment for such investment and connected purposes,”.

The act provided for manufacturing, commercial and later service activities to be undertaken by licensed EPZ enterprises operating in specific industrial park locations called zones. The zones are designated by the minister responsible for the affairs of the EPZ activities through a legal notice in the Kenya Gazette. The Act provides for a number of incentives to be given to EPZ enterprises and developer/operators. The three major categories of incentives are: i) Fiscal incentives category designed to reduce anti-export bias by reducing taxation costs. These were exemptions from income tax, import duty, withholding tax, value added tax (VAT), stamp duty and provision of an investment allowance; ii) procedural incentives designed to reduce bureaucracy and fast track investment activities. These included exemption from compliance with various national laws and defined services delivery standards by EPZ authority.

The incentives committed the authority to processing of applications for EPZ licenses within 30 days; and iii) infrastructural incentives designed to reduce start up time and costs by providing investors with ready factory units, serviced land and office space. All zones are intended to have basic essential infrastructure developed to defined standards for water supply, sewerage treatment, electricity and internal road, as well as provide factory shells and ancillary services such as security, perimeter fence, on – site customs services. Both private and public zone developments were allowed. The economic objectives of the program as developed from the EPZ Act were expansion and diversification of exports, attraction of new productive investment, generation of employment, creation of backward and forward linkages, foreign exchange, earnings and increase of technology and skills transfer. Indeed these are the standard objectives of the EPZs world over.

Despite the challenges caused by uncoordinated policy changes, bureaucratic red tape and negative publicity by labor movement, the EPZ program has registered positive growth over the years and contributed significantly to Kenya’s economic development.

2.3 Performance measurement

Firm performance can be measured in many different ways. According to Crick and Spence, (2005), performance measurements in the literature until the 1980s largely concentrated on financial indicators, such as profit, return on investment, sales per employee, and productivity. Commencing from the late 1980s onwards, less tangible and non-financial measures have been extensively employed in tandem with the advent of new management, just-in-time delivery (JIT) and total quality management (TQM). Intangible measures include communication, learning, trust (Zahra *et al*., 2000) stakeholder satisfaction, competitive position quality of product, and throughout rate.

Nevertheless, many empirical studies tend to employ tangible variables in measuring firm performance because they are easier to operationalize. Garrigos-Simon*et al*. (2005) in their study on Spanish hospitality firms adopted two quantitative measures, which are profitability (return on assets, return on investment and return on sales) and growth (in sales, market share, and wealth creation); and two qualitative measures, namely stakeholder satisfaction, and competitive position. McNamee *et al*. (1999) in their study on Irish small businesses used two performance measurements, which are, growth (in sales volume and employment) and profitability (return on assets, return on sales, and profit per employee). A study by Powers and Hahn, (2002) on the banking industry in New England only employed one indicator, return on assets (ROA), to compare the performance of 98 banks.

3.0 METHODOLOGY

The purpose of the study was to investigate the firm resources required by SMEs of foreign entrepreneurs when investing in Kenya. The focus was on the manufacturing foreign SMEs at the Export Processing Zones. The study employed both qualitative and quantitative design and also involved use of structured and non-structured questionnaires administered to the EPZ foreign manufacturing SMEs who served as the primary respondents. The financial statements submitted by the companies to the Kenya Revenue Authorities (KRA) and other regulatory agencies such as the EPZ authority were obtained as secondary data.

The study population comprised of the manufacturing foreign firms at the Export Processing Zone (EPZ) in Kenya. The population of the study comprised of all foreign manufacturing small and medium firms within the EPZ, whose total initial capital did not exceed KShs. 50 million The respondents comprised of the persons within the management levels. The potential respondents formed 52.1% (n=37/71) of the entire EPZ population. The foreign manufacturing SMEs were 80.4% (n=37/46) and this was a sufficient representation of the study population (Saunders, 2001).

4.0 RESULTS

The main purpose was to study the firm resources that foreign entrepreneurial firms need to possess in order to invest and perform in Kenya.

4.1 Characteristics of the respondents

The respondents characteristics reviewed included; sources of FDI, firm sectors, period of operation and managerial position of the respondents. Five continents formed the main sources of inward FDI in Kenya. These include North America, Europe, Asia, South America and Africa.

It was observed that most of the companies in the EPZ were from Asia making a 40.5% followed by Europe 24.3% and African countries 18.9%. South America had the lowest respondents 5.4%.

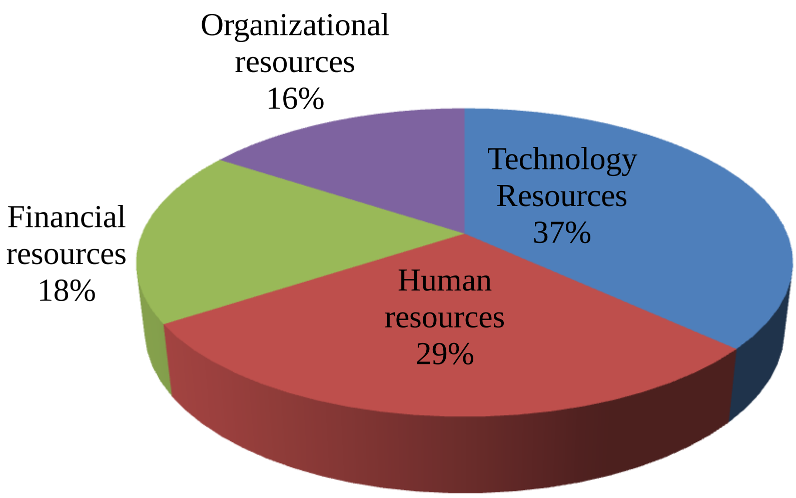
Regarding the firms, the result indicates that 38.7% of foreign manufacturing firms comprised of textiles industries. Textiles in this case comprised of textile garments, fishing and sports nets, fabric and yarn, textile accessories for examples labels, tags and carpeting among others.

The respondents were asked to state the number of years they had operated in Kenya. Having operated in Kenya for a long period would give more accurate assessment of the country's investment climate. The findings show that 81% of the firms have been operating in Kenya for 10 year According to Wijewardena and Tibbitts, (1999) young firms tend to grow rapidly because they have innovative ideas and dynamic management.

The respondents for this study were strictly those in management positions. The right source of information is crucial to any research study. Almost half of the respondents making 48.6% were human resource managers. This was crucial in that it allowed intensive investigation among officers whom the study considered information rich since they are involved in the management of the firm.

4.2 Firm resources as a determinant of FDI SMEs performance

Firm resources are vital to the firm performance. Firm resources are defined as assets, processes and knowledge that allow managers to design and implement efficient and effective strategies. Firm performance is also influenced by the strategies and resources brought to bear within a particular operating environment. Firm resources include technology resources, human resources and organisational resources that enable SME managers to design and implement efficient strategies (Baker and Nelson, 2005). The themes that guided this objective included technology, human resources, financial sources and organizational resources.



Various firms resources allocation in the SMEs

Findings indicate that the most valuable firm resources is technology with 37% (n=14), of the respondents. Empirical studies have shown that international firms often transfer resources such as technology, brand name and process innovation in their subsidiary performance because such transfer of technology to subsidiaries, offer innovative products and quality services (Chandler, 1977). The second most valuable firm resources include human resources accounting for 29% which refers to knowledge and skills of all working staff within the organisation.

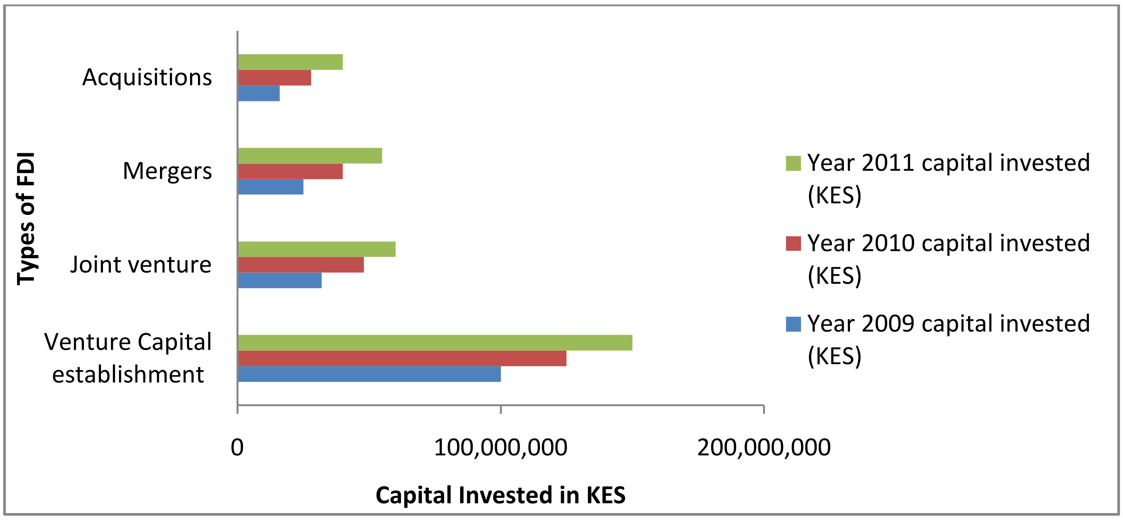
The need for financial resources was ranked third at 19%. Financial resources are essential to FDI as they give firms a greater degree of freedom to contemplate wide-ranging foreign expansion possibilities without necessarily compromising opportunities, and make the expansion process much smoother and less problematic (Core and Wrengly, 2007). Organisational resources accounted for 15% was the fourth type of resources which refers to a firms internal reporting, controlling and coordinating systems, as well as relations with other firms. The environment of firms' internal relationship can have greater impact on its performance from the external point of view, good relationship with business partners and customers are strongly linked to cooperation among groups and performance of the Focal Company (Chandler, 1977).

4.3 Performance of foreign direct investing SMEs

The performance of foreign direct investment SMEs was measured quantitatively using secondary data obtained from the firm's annual audited accounts. The three measurements included; capital invested annual sales turnover and profitability. Performance was also qualitatively measured by use of networks. The findings are presented in the following s

4.3.1 Capital invested on FDI SMEs performance

Capital invested was analysed on the type of FDI. The secondary data was obtained from the responding firms annual audited accounts for three years (2009, 2010 and 2011). The results indicated that each of the clusters had a substantial increase of the capital invested in Kenya. For instance the capital invested in venture capital establishments increased from KShs. 100 million in year 1 to KShs 150 million in years 3. The total amount invested by all respondents increased from KShs 173 million in year 1 to KShs 305 million. Financial resources are essential to FDI performance. Affluent financial resources give firms a greater degree to freedom of contemplate wide ranging foreign expansion possibilities without necessarily compromising among opportunities, and make the expansion process much smoother and less problematic (Hu and Bentler, 1995).



Showing capital invested by a category of FDI in three years.

4.3.2 Annual sales turnover on FDI SMEs performance

The annual sales were analyzed from the secondary data obtained from the firms audited accounts for each of the FDI type. As indicated in table 4.7 each of the FDI cluster has a substantial annual sales increase for each of the three years. The annual sales turnover for each year/period was determined as percentage increase in sales. The percentage growth in sales turnover was determined using the formula;

$$\frac{\text{Sales in year 3} - \text{sales year 1}}{\text{Sales in year 1}} \times 100\%$$

The category that registered the highest sales turnover was acquisition with 126.7% from 30 million to 60 million within 3 years of operation. Mergers at 112.5%, and the joint ventures with 92.3% followed this, and the lowest was green field investments with growth of 50%. This shows that FDI SME’s all experienced high performance in terms of sales in Kenya within the 3 years of operation under review.

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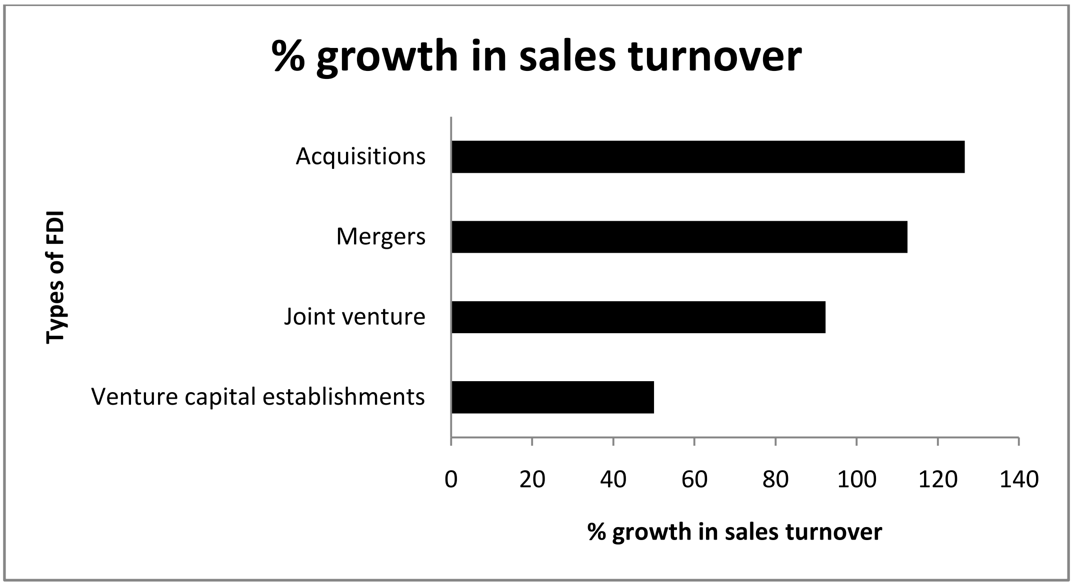


Percentage growth in sales turnover

Generally, there was a growth of all FDIs categories within the three-year period of operations with 78.9% increase in annual sales turnover. Whether this trend is sustainable can only be determined if the study is carried over a longer period. This shows a favorable business climate for foreign SMEs in Kenya.

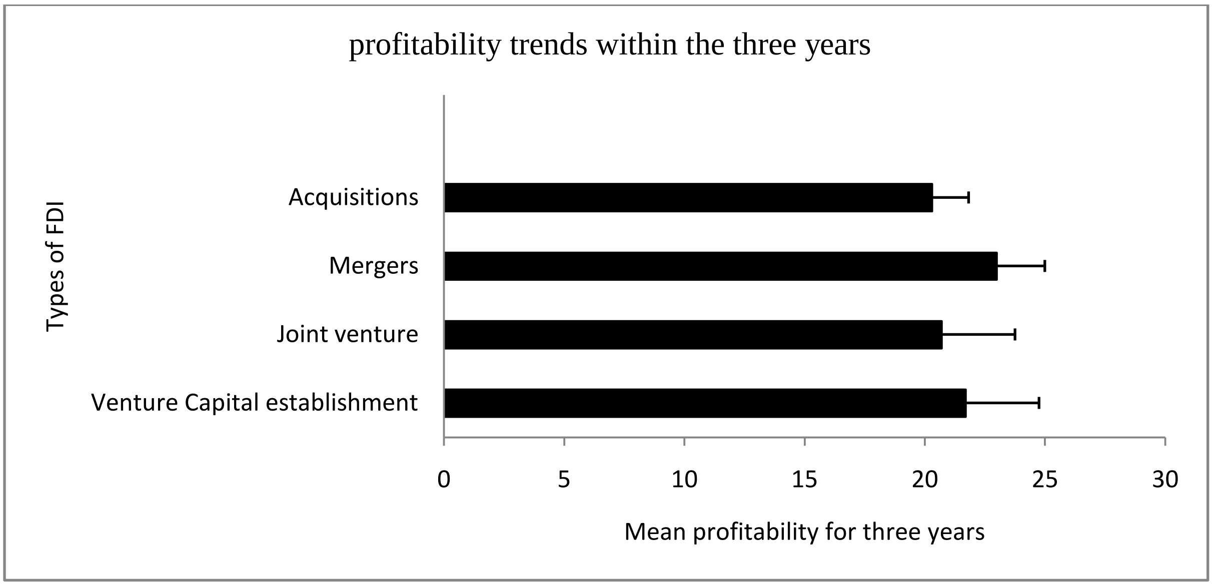
4.3.3 Profitability on FDI SMEs performance

The trends in FDI cluster profitability was calculated using the secondary data from the firm's annual audited accounts as indicated in table 4.8. Profitability was determined by the following formula;

$$\frac{Year\ 3\ profitability - year\ 1\ profitability}{Year\ 1\ profitabilty} \times 100\%$$

The average and standard deviations of three years profitability was then calculated.

In table 4.8, all the FDI clusters showed a remarkable increase from year 1 to year 3. For instance, the trends for venture capital establishment increased from 19% in year 1 to 25% in year 3 with percentage increase of 21.7%. The overall increase for all FDI clusters increased from 19.25 % in year 1 to 24% in year 3 with a mean percentage increase of 21.4%.



The category showing the greatest increase in profitability was mergers with average profitability of 23%, followed by venture capital establishment with 21.7% and the lowest was acquisitions with 20.3%. In overall, mergers had the highest profitability on average at 23% while acquisitions had the lowest average for the 3 years at 20.3%.

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

The study was concluded based on the three objectives which included; mode of entry, host country factors and firm resources as determinants of FDI SMEs performance.

Firm performance is also influenced by the strategies and resources brought to bear within a particular operating environment. The resources considered in this study included technology resources, human resources and organisational resources. Out of these four types of firm resources only technology resources were found to be positively significant and positively related to performance. As far as technological resources are concerned, a firm's technology profile has long been thought to play a key role in several international business issues, such as entry strategy and mode of operations.

Empirical studies have shown international firms often transfer resources such as technology, brand name and process innovation to their subsidiaries in foreign markets. Leading to superior subsidiaries performance because such transfers of technology allow subsidiaries to offer innovative products and quality services in the host country. Freeman and Reid (2006) indicated SMEs, in their FDI process, faced three critical constraints including the lack of economy of scale, lack of financial and knowledge resources and aversion to risk taking. A major impediment to FDI expansion of manufacturing SMEs is the lack of finance, which may discourage them from pursuing FDI opportunities.

5.2 Recommendations

Based on the above analysis, policy recommendations and implications are given as follows

1. Advanced technology is a key element to establish comparative advantage for FDI firms. Therefore, innovation capacity of FDI firms should be improved via strengthening their absorption capability and increasing research and development inputs.
2. Management system and FDI management experience should be enhanced. To improve FDI management experience, networking and knowledge-based activities should be encouraged.
3. Despite the lack of significance of the controlling resource capacity on the performance of firms, it should not be overlooked. Financing capacity and senior managers with management know-how are the decisive factors in internationalization. Therefore, corresponding inputs should be increased for firms in order to pave way for further internationalization.

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