FACTORS AFFECTING OUTSOURCING OF ACCOUNTANCY SERVICES BY SMALL AND MEDIUM ENTERPRISES IN KENYA

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ABSTRACT

SMEs are important to economic growth and are essential to economic development in Kenya. However, many of them do not have skilled accountancy personnel and the infrastructure necessary to implement existing accountancy rules and regulations. They therefore opt to outsource this business function and this trend has been growing and this could be due to many factors. Given the growing trend of outsourcing of accountancy services by SMEs, it is important to understand the factors affecting this practice. The top 100 SMEs in 2012 were used for this study. Primary data from the purposively sampled SMEs was collected by use of semi-structured questionnaires filled by the senior managers, CEOs or Finance Managers of the SMES. The study found that SMEs outsource accountancy services. Outsourcing is aimed reducing and controlling operating costs, enhancing access to an external and relatively at low cost structure. Lack of in-house expertise is a factor in SMEs' outsourcing decision-making. External expertise gives SMEs competitive advantage and increases their chances of survival in the current market. SMEs take a broader view of accountancy outsourcing by isolating their core competencies. New technologies enhance SMEs' growth and maintain the standards provided under International certifications like ISO. SMEs have relatively high ICT uptake with computers and internet infrastructure being used in their accountancy areas. SMEs need to manage demand efficiently through outsider's automation, process maturity and latest technology, and obtain technologies which otherwise will not be available from within. The study recommends that SMEs should intensively and expansively focus on outsourcing services based on cost, availability of in-house expertise, core competencies, and technology.

Key Words: *outsourcing, accountancy services, Small and Medium Enterprises in Kenya*

Introduction

Small and Medium-Sized enterprises (SMEs) play an important role in all economies and are the key generators of employment and income all over the world (OECD, 2009). However, majority of SMEs in emerging economies cannot compete effectively due to their internal resource gap (UNIDO, 2003). In the global value chains, smaller firms have been vulnerable than larger firms because they lack the necessary resources and capability for survival and growth. The SMEs are even more vulnerable as they often bear the brunt of the difficulties of large firms (OECD, 2009). SMEs faced with resource gap and competitive pressures, they are forced to lessen their costs and create new opportunities through optimized utilization of external resources.

SMEs have been an important economic pillar in the emerging economies. In a presentation to the Diaspora Conference in Washington DC on 8th – 9th October 2011, Kenya Capital Markets Authority (CMA) indicated that the establishment of a Small and Medium Enterprises (SME) Exchange was as a result of SMEs being clearly identified and appreciated as drivers of economic growth in Africa (CMA, 2011). Their growth will generate increased employment, wages, goods and services as well as tax revenues. CMA (2011) asserted that well nurtured, today's SMEs will become tomorrow's main market listings.

Companies outsource some of their activities or processes for different reasons. Among the most frequently cited reasons for outsourcing is reduction of costs. There are also different reasons for outsourcing which include organizational reasons, improvement reasons, financial and cost reasons as well as revenue reasons (Ghodeswar and Vaidyanathan, 2008). An understanding of these factors would be important for examining SMEs Accountancy services outsourcing practices.

Statement of the Problem

Small and Medium-Sized enterprises are important to economic growth and are essential to economic development in both developed and developing countries. However, many SMEs do not keep proper financial records and accounts because they are not aware or convinced of the usefulness of accounting and financial reporting requirements for control and decision-making purposes. Many SMEs choose to outsource accounting work rather than hiring an accountant at a high cost (United Nations Conference on Trade and Development, 2000). Given the growing trend of outsourcing accountancy services by SMEs, it is important to understand the factors that affect this practice. Of particular concern in this study are the factors affecting outsourcing of accountancy services by SMEs in Kenya.

Previous studies have not focused on drivers of outsourcing accountancy services by SMEs in Kenya. Instead, these researchers (Kinyua, 2000; Serem, 2003; Mohamed, 2006; Langat, 2007) concentrated on outsourcing in large organizations and predominantly in the banking sector. In the current study, the researcher will focus on the effect of cost considerations, access to information, core competencies, and technology on outsourcing of accounting services by Kenyan SMEs. Previous research indicates that the need to manage the accounting function through outsourcing has not been met by most SMEs. Most SMEs are still unaware of their financials and their books are not kept as per laws and regulations governing the profession. This has also led to non-compliance with tax laws, with most SMEs failing to pay taxes up to date due to lack of proper record keeping and incorrect financial reporting. Given this background, it is important to understand the factors affecting outsourcing of accountancy services by the Top 100 SMEs in Kenya.

General Objective of the Study

To determine the factors affecting outsourcing of accountancy services by SMEs in Kenya.

Specific Objectives

1. To establishthe effect of cost considerations on outsourcing of accountancy services by Kenyan SMEs.
2. To determine the effect of access to information on importance of accountingon outsourcing of accountancy services by Kenyan SMEs.
3. To determine the effect of core competencies on outsourcing of accountancy services by Kenyan SMEs.
4. To examine the effect of technology on outsourcing of accounting function by Kenyan SMEs.

Literature Review

Many scholars view outsourcing as the only approach to keep businesses competitive into the twenty-first century. Outsourcing is regarded as one of the most popular management strategies to surface in response to calls for more efficient ways to address organizational competitiveness. Rapid changes in the business environment require organizations to consider outsourcing that will encourage a competitive advantage for future success (Bolat and Yilmaz, 2009). Large-scale outsourcing has become an accepted and viable alternative for many organizations. The trend towards outsourcing is becoming popular in all sectors where outsourcing of services such as logistics (Boyson*et al.*, 1999), human resource management (Delmotte and Sels, 2008; Gilley *et al.*, 2004), accounting (Everaert*et al.*, 2007) and procurement activity (Parry *et al.*, 2006) has been going on for many years (Lever, 1997).

Conceptual Framework

The conceptual framework of the study examined causal relationships between dependent and independent variables shown below:

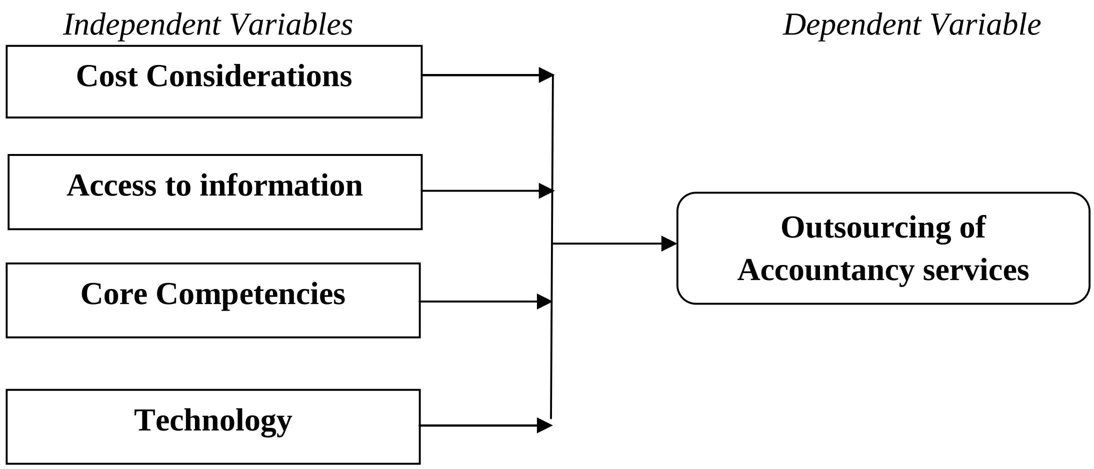

Figure 2.1: Conceptual Framework

Review of Variables

As shown in Figure 2.1, the independent variables will be cost considerations, access to information, core competencies and technology. Cost considerations will refer to those expenses incurred by an SME when outsourcing for accountancy services. Such costs could include billing cost, operation cost, coordination cost and overhead cost among others. Access to information in this study will refer to the capacity for an SME owner to acquire structured, meaningful information which assists an entrepreneur to make knowledgeable business decisions. Lack of information creates a gap or uncertainty in knowledge or an anomalous state of knowledge in relation to certain business process, in this case outsourcing for accountancy services. Core competencies will refer to the skills needed in order to competently outsource for quality accountancy services. The skills can be grouped into three broad categories, namely technical skills, human skills and conceptual skills (Robbins,2003). Technology will refer to the process by which basic science research and fundamental discoveries are developed into practical and commercially relevant applications and products. These four factors are expected to affect outsourcing of accountancy services by SMEs, which is the dependent variable.

Methodology

Research Design

This study adopted a descriptive survey design. Survey method is useful as it helps the researcher to collect data on phenomena that cannot be observed directly (factors affecting outsourcing of accountancy services by SMEs in Kenya). The advantage of this method is that, it allowed collection of large amounts of data from SMEs in a highly effective, easily and in an economical way. According to Babbie (2002), this design refers to a set of methods and procedures that describe variables. It involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data. Descriptive surveys portray the variables by answering who, what, and how questions (Babbie, 2002).

Study Population

The target population was small and medium sized companies in Kenya. This study focused on the top 100 SMEs in 2012 as surveyed by *Business Daily* and KPMG (See Appendix III for full list of the SMEs). Top 100 SMEs list is considered credible as it was developed by KPMG, a reliable audit and advisory firm, and Nation Media Group, a renowned media house in Kenya. All the senior managers or the chief executive officers from the targeted SMEs comprised the target.

Data Collection instruments

Primary data was collected through semi-structured questionnaires with both open and closed ended questions. The questionnaire was divided in sections where each section will seek information on a specific objective. One questionnaire was administered to each company and addressed to a senior manager or a CEO. Drop-and-pick later methodwas used to administer the questionnaires. This enhanced the response rate given that the managers of Top 100 SMEs are expected to be busy and needed to respond to this questionnaire at their convenient time. Secondary data was collected from publications and relevant records on the Top 100 SMEs in Kenya.

Validity and reliability of the questionnaire was enhanced by carrying out a pilot study prior to data collection. Validity is the degree to which a test measures what it purports to be measuring. This is how well a test measures what it is intended to measure. Validity can also be said to be the degree to which results obtained from and analysis of data actually represent the phenomenon under investigation (Orodho, 2004). The researcher will test both face and content validity of the questionnaire. Face validity refers to the likelihood that a question was misunderstood or misinterpreted. According to Wilkinson (1991), pre-testing a survey is a good way to increase the likelihood of face validity. A pilot study was used to identify those items that could be misunderstood, and such items will be modified accordingly, thus increasing face validity. Content validity refers to whether an instrument provides adequate coverage of a topic. Expert opinions, literature searches, and pre-testing of open-ended questions help to establish content validity (Wilkinson, 1991). The researcher prepared the instruments in close consultation with his supervisors, and ensures that the items in the questionnaire will cover all the areas under investigation.

Reliability of an instrument is the consistency in producing a reliable result. Reliability focuses on the degree to which empirical indicators are consistent across two or more attempts to measure the theoretical concept (Orodho, 2004). Prior to visiting the schools for data collection, the researcher will pre-test the questionnaire using three SMEs, but which was not be included in the final sample. The purpose of the pilot study was to test the reliability of the instrument.

Data Analysis

The study used both quantitative and qualitative data. Quantitative data was analyzed using descriptive statistics such as frequencies, percentages and mean standard scores. The results of quantitative data analysis were presented in tables and figures. Qualitative data on the other hand will be analyzed using content analysis. Responses were analyzed based on objectives and running themes were identified and grouped according to categories. Conclusions were made from the most cited themes. Results of qualitative data analysis was presented in prose or narrative format.

Conclusions

From the study, SMEs do outsource a number of accountancy services which their employees do not directly specialize in. Outsourcing is aimed at reducing costs especially through eliminating fixed costs associated with employing internal staff members to provide accountancy services. It also reduces and controls operating costs, enhances access to an external and relatively low cost structure, and enhances a firm’s performance. Lack of in-house expertise that is knowledgeable and supportive in accountancy is also an input in the SMEs’ outsourcing decision-making. By outsourcing such expertise, SMEs' attains the capacity to sustain their competitive advantage and increases their chances of survival in the current market through skills and innovative ideas. Cost savings is important to every SME. However, it is no longer the only factor in an outsourcing decision. SMEs take a broader view of accountancy outsourcing by isolating their core competencies, and then chipping away all the services that do not contribute to them. Since core competencies are the most important activities to the SMEs, most CEOs and managers ensure that they stay inside the SMEs’ control while outsourcing accountancy services. In conclusion, the need to expand capacity to design, test and build new products and services, stretch SMEs limits in handling the increased volume of business; and build enablers of business growth and strategies to fulfill them influence the decision to outsource accountancy services to a very great extent. New technologies enhance SMEs’ growth and maintain the standards provided under International certifications like ISO. In addition, some SMEs have relatively high ICT uptake with computers and internet infrastructure being used in their accountancy areas. To them, technology-based accounting is a source of comfort for potential customers and other stakeholders because it ensures that finances are well monitored and proper systems and software can detect and correct errors. Most of the SMEs therefore base their decision to outsource accountancy services on technology. SMEs need to manage demand efficiently through outsider’s automation, process maturity and latest technology, and obtain technologies which otherwise will not be available from within.

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