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Effect of Management Practices on the Financial Performance of Manufacturing Firms in Kenya

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Abstract

The assessment and projections of economic growth of Kenya is pegged on the increase in the contribution of the manufacturing sector to the economy. However, this has not been achieved despite prominence in the government development blueprints such as Vision 2030. In reality, the performance and contribution of the Kenyan manufacturing firms to the economy has been worrying especially in the wake of realizations that other sectors of the economy such as real estate and telecommunications have surpassed it on the contribution to the GDP. In Kenya, Manufacturing share of total Kenyan economic output has stagnated at 10 with a declining contribution to total wage employment. It is this fact that necessitated an enquiry on the role of micro factors on the financial performance of manufacturing firms in Kenya. The specific objectives were; examine the relationship between production capacity and firm financial performance; to establish the relationship between management practices and firm financial performance, to determine effect of operations practices and firm financial performance, and to establish the moderating effect of firm size on micro factors on firm's financial performance. Agency theory is used as the foundational theory, with enforcements from wealth maximization theory and the resources based theory. The research design was descriptive research design. Data was collected using a self-administered questionnaire, from a population of 180 manufacturing firms in Kenya. The response rate was 95%. Descriptive statistics, correlation and regression techniques were used to analyze the data. Management practices were found to be satisfactory variables in explaining financial performance of manufacturing firms in Kenya. This is supported by coefficient of determination also known as the R square of 14.5%. Regression of coefficients results showed that financial performance of manufacturing firms and management practices are

positively and significant related. The study concluded that there is a positive relationship between and management practices and manufacturing firms' financial performance. The study recommends and management practices by adopting relevant leadership skills.

Keywords: *management practices, financial performance of manufacturing firms, Kenya*

1.1 Introduction

Determinants of firm's performance are under consideration of investigation since the evolution of modern firm. From financial point of view the ultimate goal of a firm is to maximize the stockholders' wealth and firm performance is one of the most important factors which helps to maximize the shareholder wealth. Firm performance comprises the actual output or results of a firm as measured against its intended outputs, goals and objectives (Banker, Chang, Pizzini, 2004).

It encompasses three specific areas of firm outcomes: financial performance, which includes profits, return on assets and return on investments; secondly product market performance such as sales, market share, service propositions and thirdly shareholder return and economic value added (Lipe & Salterio, 2000). For this reason, firm performance is among the most important research considerations of financial management. Factors that have important effects on determination of firm performance could be divided into micro and macro factors (Wellage, 2012).

Factors that affect the performance of manufacturing firms can either be micro factors or macro factors. Micro factors are the internal factors, whereas macro factors are the factors from external environment. Any change in the macro factors in the economy affects the firms which could be seen in the performance of the firm as well. These effects could be positive or negative depending on the change in the macro environment and structure of the firm. Even the same change in the macro environment may or may not have the same impact on the two firms which belong to the same industry (Wei & Zhang, 2008).

Micro factors are factors close to a business that have a direct impact on its business operations and success. Micro factors refer to the factors which are in direct contact with the business organization and can affect the routine activities of business straight away (Rauch, & Frese, 2000). They are associated with a small area in which the firm functions. They are also known by the name internal factors. Micro factors are a collection of all the forces that are close to the firm. These forces are very particular for the said business only. They can influence the performance and day to day operations of the company, but for a short term only. Understanding the core micro factors affecting the business helps in planning and preparation, as well as long-term business strategy development (Bøllingtoft, & Ulhøi, 2005).

The micro factors consist of those elements which are controllable by the management. Normally the micro factors do not affect all the companies in an industry in the same way, because the size, capacity, capability and strategies are different. For example, the raw material suppliers are giving more concessions to large sized companies. However, they may not give the same

concessions to small companies (Rauch, & Frese, 2000). Micro factors show a very interesting image of firms and suggest the most important areas to develop are those such as cost management, trade and marketing, production, technical development and finances (Volberda, Foss, & Lyles, 2010).

Production Capacity is a micro factor determined within the firm. It is the volume of products or services that can be produced by an enterprise using current resources. Capacity in manufacturing firms is often defined as the capability of an object, whether that is a machine, work center, or operator, to produce output for a specific time period. Companies measure capacity in different ways using the input, output, or a combination of the two as the measure (Tybout, 2000).

Performance is the result of the fulfillment of the tasks assigned. Company performance describes how individuals in the company try to achieve a goal. Company performance illustrates the magnitude of the results in a process that has been achieved compared with the company's goal. Company's performance is evaluated in three dimensions. The first dimension is company's productivity, or processing inputs into outputs efficiently. The second is profitability dimension, or the level of which company's earnings are bigger than its costs. The third dimension is market premium, or the level of which company's market value is exceeding its book value (Wellage, 2012).

Financial performance plays an important role in the company performance that is expressed in monetary term. Financial performance emphasizes on variables related directly to the financial report. Before investing their funds, investors should first know about the performance of the company. The simplest way to determine the performance of the company is to look at the company's financial statement. In this intense competition among the companies, the company is expected to be able to maintain and improve its performance in order to compete with others.

Firm performance comprises of the actual output or results of a firm as measured against its intended outputs, goals and objectives (Banker, Chang, Pizzini, 2004). It encompasses three specific areas of firm outcomes: Financial performance, namely profits, return on assets and return on investments; Product market performance such as, sales, market share, service propositions and shareholder return, specifically total shareholder return and economic value added (Lipe & Salterio, 2000). This has called for the need of balancing the accuracy and integrity of financial measures with the drivers of future financial performance of the organization (Banker et al, 2000).

Different approaches to the measurement of firm performance for financial services organizations have been used to analyze the efficiency and performance of financial sectors across the world (Berger & Humphrey, 1997). The traditional approach involves analyzing major financial indicators of the organization over time (Rahut, Castallanos & Sahoo, 2010). Profitability, earning, operational strategy, productivity, efficiency, leverage and liquidity, capital adequacy, growth and aggressiveness and market share were used by Rahut et al. (2010) to represent traditional measures of performance of financial institutions. Mwangi et al. (2013) analyzed the effect of financial innovations on the performance of commercial banks in Kenya.

The study used profitability, total income, total assets and customer deposits as proxies of performance of commercial banks. According to Dew (2007), the lifeblood of a Bank is determined by how well it can gather funds from the customers at the lowest cost; buy money, do something with the money, and then sell it to their profit.

The Strategic Balanced score card provides a framework in which both financial and nonfinancial success measures are linked by the firm's strategy (Banker, Chang, Pizzini, 2004). It looks at performance from four perspectives: financial, customer, internal process and learning and growth. According to Kaplan and Norton (1996) the strategic balanced score card can translate a company's vision and strategy into a coherent and linked set of firm performance measures; these measures should include both outcome measures and the performance drivers of those outcomes.

Financial performance indicators in the form of ratios include profitability, liquidity, utilization financial structure and investment – shareholder ratio (Philip, 2004). Measure of profitability is by gross profit margin; the amount of money made after direct costs of sales have been taken into account, operating margin; lies between the gross and net measures of profitability and net profit margin; takes all costs into account. Liquidity ratios indicate the ability to meet short- term obligations, efficiency ratios indicate how well the business assets are in use and financial leverage/gearing ratios indicate the sustainability to the exposure of long-term debt (Leah, 2008). These ratios can be combined to determine the rate of return for a company and its owners and the rate at which the company can grow the sustainable rate of growth. By adding data about the company's stock market performance, the analyst can gain insight into how financial markets view the company's performance (Qayyum and Bodla, 2010). Financial performance of could also be as a result of financial planning, financial control and decision making by the management.

There are many subjective and objective measures of financial performance of firms with equally many indicators of such performance. The financial performance of a firm is described as a measure of an enterprise's gains over its operative years, and it is determined by several factors. According to Stierwald (2009) the size of the firm is one of the specific firm level characteristics which can impact on the firm's performance (Bauer, 2004; Joshua, 2008). The size of the firm influences the option of financing that a firm may go for. Larger firms have a tendency of leveraging while smaller ones are inclined to employ equity. The firm size has a significant effect on the financial performance of the firm no matter the industry and other micro-economic variables (Raheman, Afza, Qayyum and Bodla, 2010).

Kenya is a favorite destination for investors willing to put their money in manufacturing. While the country is not endowed with the mineral wealth most of its neighbors flaunt, it more than makes up for it, thanks to the following: one of the best workforces in Africa, a productive agricultural sector and hence a dependable source of raw materials for agro-based manufacturing, a fairly versatile financial services sector, bankable telecommunications and proximity to port facilities (Wambua, 2016).

Kenya also has locational advantages as the gateway and a natural launch pad to the markets of the mostly Landlocked East and Central African countries like Uganda, Southern Sudan, Rwanda, Burundi, parts of northern Tanzania and Eastern Democratic Republic of the Congo (DRC). According to the Economic Recovery Strategy for Employment and Wealth Creation Report, the manufacturing sector in Kenya is a major source of growth, still with high potential for growth and investment. The role of the manufacturing sector in Vision 2030 is to create employment and wealth (Muthui, 2014).

Manufacturing sector in Kenya is among the key productive sectors identified for economic growth and development because of its immense potential for wealth, employment creation and poverty alleviation (Kagechu, 2013). The firms face a number of challenges that include limited access to the market, high labour costs and start-up capital. According to research (Kagechu, 2013), Kenya's manufacturing sector contributes to 10% of the Gross Domestic Product (GDP) and 12.5% of exports (Were, 2007). In recent years, manufacturing firms have increased exports of textiles, mainly targeting the US market. This is attributed to the export-led growth as a policy priority in Kenya.

Most of the firms registered under this sector are owned and operated by families. The bulk of the products manufactured include food and beverages, building and construction materials, household items and chemicals. The sector is key to achieving the country's vision of becoming prosperous and globally competitive by 2030 (Were, 2007). The manufacturing sector in Kenya has been the main conduit for the country's integration into regional and world markets like Common Market for Eastern and Southern Africa (COMESA) and the East African Community (EAC) (Were, 2007). The sector has attracted international investors as well (Muhoro, 2011).

1.2 Statement of the Problem

The manufacturing industry in Kenya has been beleaguered by obstacles. Manufacturing share of total Kenyan economic output has stagnated at 10% with a declining contribution to total wage employment (Kenya Economic Report, 2013). Nearly every news outlet has covered the closing of factories, labor disputes between companies and their employees or reductions in force due to the shift of labor off-shore (Muhoro, 2015). The reputation of the industry has been marred by low production, lack of staff motivation, remuneration and staff training, in addition to quality-control problems (Were, 2016). The assessment and projections of economic growth of is pegged on the increase in the contribution of the manufacturing sector to the economy (GOK, 2013). However, this has not been achieved despite prominence in the government development blueprints such as vision 2030.

The performance and contribution of the manufacturing firms to the economy has been worrying especially in the wake of realizations that other sectors of the economy such as real estate and telecommunications have surpassed it on the contribution to the GDP (GOK, 2014). Job loss in the industry has been ongoing in the past five years preventing the sector from moving out of the infancy stage. This is as a result of companies stopping production altogether or moving production plants to neighboring countries (Muthui, 2014). Even though several macro factor challenges are faced by the manufacturing sector that include poor infrastructure, market access

and local markets being flooded by cheap imports, improvement in micro factors can counter the effect leading to improvement in performance. It is this fact that has necessitated an enquiry on the role of micro factors on the financial performance of manufacturing firms in Kenya.

Previous research studies relevant to this study include Gill, Singh, Mathur, and Mand, (2014), study on the impact of operational efficiency on the future performance of Indian manufacturing firms, Krasnikov, and Jayachandran, (2008), study on the relative impact of marketing, research-and-development, and operations capabilities on firm performance, Tybout, (2000), study on manufacturing firms in developing countries and Muthui, (2014) study on Challenges facing Kenya's soap manufacturing firms exporting to East Africa Community. There is so far little study and evidence on how management practices affects financial performance of manufacturing companies in Kenya.

1.3 Research Objective

To evaluate the effect of management practices on the financial performance of manufacturing firms in Kenya

2.0 Literature Review

2.1 Theoretical Framework

The theory explaining the effect of management practices on the financial performance of manufacturing firms in Kenya are Agency theory and Wealth maximization Theory.

2.1.1 The Agency Theory

Campbell and Underdown (2001) argue that the success of any business enterprise is determined by the interaction of two major sets of factors micro factors and macro factors. The latter are beyond the control of business managers and include such environmental conditions as shifting preferences, the behaviour of consumers, adverse movements in commodity prices, changes in government policy and cyclical market forces. The micro factors emanate from inside the firm and encapsulate the ability of management to develop and implement planning strategies that fit the business to the environment. The probability of changes in environmental factors and the effects of such changes on future business performance should be taken into account if an enterprise is to survive and prosper.

The firm's performance, represented by gross profit, depends on the manager's effort and also a chance variable. The agency theory is a supposition that explains the relationship between principals and agents in business. Agency theory is concerned with resolving problems that can exist in agency relationships due to unaligned goals or different aversion levels to risk. The most common agency relationship in finance occurs between shareholders (principal) and company executives, agents (Eisenhardt and Martin, 2000).

Agency theory addresses problems that arise due to differences between the goals or desires between the principal and agent. This situation may occur because the principal isn't aware of the actions of the agent or is prohibited by resources from acquiring the information. For example, company executives may have a desire to expand a business into other markets. This

will sacrifice the short-term profitability of the company for prospective growth and higher earnings in the future. However, shareholders that desire high current capital growth may be unaware of these plans (Campbell and Underdown, 2001).

Another central issue dealt with by agency theory handles the various levels of risk between a principal and an agent. In some situations, an agent is utilizing resources of a principal. Therefore, although the agent is the decision-maker, they are incurring little to no risk because all losses will be the burden of the principal. This is most commonly seen when shareholders contribute financial support to an entity that corporate executives use at their discretion. The agent may have a different risk tolerance than the principal because of the uneven distribution of risk.

2.1.2 The Shareholder Wealth Maximization (SWM) Theory

According to John, Loy & Clements-Croome, (2005), the main aim of a company is to maximize its stock market value. Managers of the company are responsible for achieving that aim, i.e. for maximizing shareholders' wealth. The performance that a company achieves reveals how successful the management is in adapting to changing circumstances. The ability to quickly and properly react to changes in the business environment characterizes the quality of the company's management. Bharadwaj, (2000) argue that the shareholder wealth maximization (SWM) theory immediate operating goal and the ultimate purpose of a firm is and should be to maximize return on equity capital. The SWM specification of firm objective makes operating goal and ultimate purpose the same. Managers and investors should focus narrowly on SWM.

The question of whether the firm objective can be a strict emphasis on SWM or must recognize significant differences between the operating goal for managers and investors and the ultimate social purpose of the public corporation lies at the intersection of three literatures. In economics and finance literature, SWM is a standard assumption (John, Loy & Clements-Croome, 2005). This SWM operating goal is expected to yield the most socially efficient allocation of capital. Business ethics, corporate social responsibility, and stakeholder theory literature emphasizes significant differences between an operating goal of SWM and the ultimate social purpose of the public corporation. Corporation law addresses duties, responsibilities, and rights of both financial and non-financial stakeholders.

2.2 Empirical Literature

According to a study done by Carolyne (2015), it was found out that good supplier management practices had a constructive impact on the performance of the manufacturing firm. Walker (2012) defines strategic management practices as the means of aligning the management of human resources strategy in support of accomplishing former and defining it. There are benefits that come along with foreign management skills acquired through foreign ownership to the host country. Beneficial spin-off effect arises when local personnel who are trained to occupy managerial, financial and technical posts in the subsidiary of a foreign MNE vacate the firm and help to inaugurate local firms. Similar benefits may arise if the superior management skills of a foreign MNE stimulate local suppliers, distributors and competitors to improve their own management skills.

A study done by Kannan and Tan (2005) highlights three types of managerial benefits: Entrepreneurial competence in seeking out investment opportunities, Externalities rising from training gained by employees for instance technical, managerial, secretarial and so on. As studied by Dunning (1993). OM practices focus on systems management and include Information and Communication Technology (ICT), Just in Time (JIT), Total Quality Management (TQM), and lean production, amongst others. HRM practices focus on people supervision, in particular the recruitment, development and management of employees Wood and Wall (2002). Progress, empowerment and teamwork are involved in training.

Moreover, it is important for a company to hire enough skilled and educated employees providing them with lifelong learning for it to be able to compete in the global economy as suggested by (Nadler & Wiggs). Roberts and McDonald (2002) noted these as some of the challenges faced by workers and organizations and termed as hindrances to effective management practices, training and growth of human resources in a global economy. Only commonality shared by all the studies is that the management practices are measured in a multidimensional method according to Lawrence and Hottenstein, (2005) who concluded the lack of harmony in the literature on how to measure management practices. Because of the inherently intangible nature of management practices, it is challenging to incorporate objective forms of measurement. Measures are gathered to enable analysis at the plant, firm, industry or country level. Just in time management (JIT) and Total Quality Management (TQM) are two management practices regularly forming the pillars of intelligible organizational systems initially stimulated by Japanese production systems and targeted at maximizing the speed of product conveyance and service quality.

Management Practices is required of the management teams including supply chain relations. In the context of manufacturing firms, supply chains are becoming progressively complex and dynamic; distribution channels are expanding with an increasing dependence on outsourced manufacturing and logistics as viewed by Smith (2004). Furthermore, globalization and fast changing business practices are putting organizations under tremendous pressure to constantly improve product or process quality, delivery index, performance, and responsiveness along with reducing costs. Necessity to improve on supplier-buyer associations is becoming more deceptive in the quest to achieve operational brilliance as studied by Smith (2004). Kannan and Tan (2005) conclude that increased outsourcing implies greater reliance on suppliers and proportionate need to manage the supplier. Comprehensive understanding of buyer – supplier association has become increasingly of importance to the overall competitiveness of a firm as studied by Berkowitz (2004). Improvement in buyer and supplier performance occurs as a product of applying operational supplier development programs as studied by Gunasekaran and Ngai (2005). With increased outsourcing, buyers must ensure that their supplier capabilities match their expectations in order to compete in the competitive market as studied by Krause and Ellram (1997), Handfield, Krause, Scannel and Monczka (2000). Goffinet *al* (2006) and Li *et al* (2006) affirm that manufacturing firms have realized the importance of the performance of their suppliers to the founding and nourishing of their competitive advantage.

2.3 Conceptual Framework

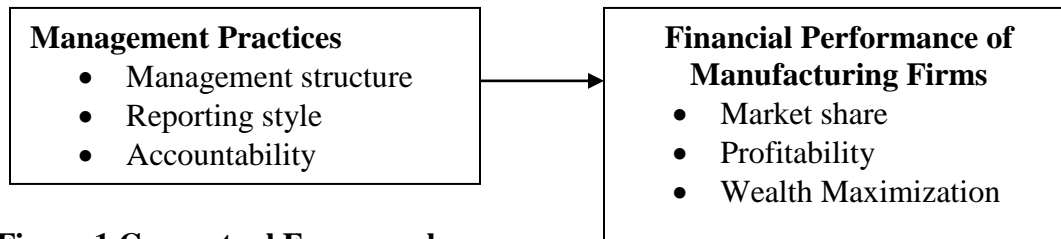


Figure 1 Conceptual Framework

3.0 Research Methodology

The study adopted a descriptive survey design. The target population was 180 CEOs of the manufacturing firms. This study used primary data which were collected through the use of a questionnaire. To check the validity and reliability of the questionnaires in gathering the data required for purposes of the study, a pilot study was carried out. Data analysis was conducted using SPSS version 20. Both descriptive and inferential statistics were generated. The specific descriptive statistics included percentages and frequencies while the inferential statistics included a multiple linear regression model and Pearson correlation.

4.0 Research Findings and Discussion

4.1 Response Rate

The number of questionnaires that were administered was 180. A total of 172 questionnaires were properly filled and returned. This represented an overall successful response rate of 95.56% as shown on Table 1. According to Mugenda and Mugenda (2003) and also Kothari (2004) a response rate of 50% is adequate for a descriptive study. Babbie (2004) also asserted that return rates of 50% are acceptable to analyze and publish, 60% is good and 70% is very good. Based on these assertions from renowned scholars 90 % response rate is adequate for the study.

Table 1: Response Rate

Response	Frequency	Percent
Returned	172	95.56%
Unreturned	8	4.44%
Total	180	100%

4.2 Influence of Management Practices on Financial Performance of Manufacturing Firms

This section presents the descriptive results on statements on management practices on financial performance. Descriptive statistics were obtained through running the statements of each objective using descriptive custom table and presenting in percentages. The respondents were asked to give their opinion regarding management practices on financial performance of manufacturing firms in Kenya.

Table 2: Management Practices

Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std. Dev
Organized Management is responsible for increased profitability of the company	39.0%	43.6%	1.2%	7.6%	8.7%	2.03	1.22
In our firm the managers ensure that there are clear roles vision and mission of the firm	7.6%	16.3%	5.8%	29.7%	40.7%	3.80	1.33
In our firm, there is a proper management policy and thus translating to increased profitability	8.7%	9.9%	11.0%	25.0%	45.3%	3.88	1.32
The flow of information, resources and feedback is all attributed to good management style	6.4%	5.8%	16.9%	33.1%	37.8%	3.90	1.16
The leadership ensures employees are innovative	7.0%	8.7%	17.4%	28.5%	38.4%	3.83	1.23
Everyone's opinion is taken highly and weighted in decision making	4.7%	7.6%	8.1%	51.2%	28.5%	3.91	1.04
Management upholds accountability and transparency leading to improved firm's revenue	17.4%	16.3%	10.5%	27.9%	27.9%	3.33	1.47
The reporting channels are clear and quick	12.2%	4.7%	15.7%	32.0%	35.5%	3.74	1.32
Average						3.55	1.26

According to results in Table 2, 82.6% disagreed with the statement that organized management is responsible for increased profitability of the company. Results also indicated that 70.4% agreed that their firm managers ensured that there are clear roles vision and mission, 70.3% agreed that there was a proper management policy in their firm which translate to increased profitability, 70.9% agreed with the statement that the flow of information, resources and feedback was all attributed to good management style, 79.9% agreed with the statement that the leadership ensures employees were innovative, 79.7% agreed with the statement that Everyone's opinion is taken highly and weighted in decision making, 55.8% agreed that management upholds accountability and transparency leading to improved firm's revenue while 77.5% of the respondents agreed that the reporting channels were clear and quick. On a five-point scale, the average mean of the responses was 3.55 which mean that majority of the respondents agreed with most of the statements; however, the answers were varied as shown by a standard deviation of 1.26. The highest of the mean was 5 while the lowest was 1. Therefore, a mean of 1=strongly disagree, 2=Disagree, 3=Neutral, 4=Agree and 5=Strongly agree. Therefore, average mean of the responses was 3.55 which mean that majority of the respondents agreed with most of the statements.

4.2.1 Relationship between Management Practices and Financial Performance of Manufacturing Firms.

Simple linear regression was carried out to determine the relationship between management practices and financial performance. Regression analysis was performed by using the composites of the two variables. The data was input to the SPSS software. Results were then presented in Tables 3, 4 and 5.

Table 3: Model Fitness

Indicator	Coefficient
R	0.381
R Square	0.145
Adjusted R Square	0.140
Std. Error of the Estimate	0.4275327

The results presented in Table 3 present the fitness of model used in the regression model in explaining the study phenomena. Management practices were found to be satisfactory variables in explaining financial performance of manufacturing firms in Kenya. This is supported by coefficient of determination also known as the R square of 14.5%. This means that management practices explain 14.5% of the variations in the dependent variable which is financial performance of manufacturing firms. This results further means that the model applied to link the relationship of the variables was satisfactory.

Table 4: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.279	1	5.279	28.883	.000b
	Residual	31.073	170	0.183		
	Total	36.353	171			

Table 4 provides the results on the analysis of the variance (ANOVA). The results indicate that the model was statistically significant. Further, the results imply that the independent variables, management practices, are good predictors of financial performance in manufacturing firms. This was supported by an F statistic of 28.883 and the reported $p=0.00$ which was less than the conventional probability of 0.05 significance level. Regression of coefficients results in Table 5 shows that financial performance of manufacturing firms and management practices are positively and significant related ($r=0.295$, $p<0.05$).

Table 5: Regression of Coefficients

sub construct variable	B	Std. Error	Beta	t	sig
(Constant)	2.447	0.206		11.895	0.000
Management Practices	0.295	0.055	0.381	5.374	0.000

5.0 Conclusion

The study concluded that there is a positive relationship between management practices and manufacturing firms' financial performance. There are benefits that come along with management skills. Necessity to improve on supplier-buyer associations is becoming more deceptive in the quest to achieve operational brilliance.

6.0 Recommendation

The study recommends and management practices by adopting relevant leadership skills. Management Practices is required of the management teams including supply chain relations. In the context of manufacturing firms, supply chains are becoming progressively complex and dynamic; distribution channels are expanding with an increasing dependence on outsourced manufacturing and logistics. Furthermore, globalization and fast changing business practices are putting organizations under tremendous pressure to constantly improve product or process quality, delivery index, performance, and responsiveness along with reducing costs.

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