DETERMINANTS OF OUTSOURCING OF ACCOUNTING FUNCTION AND ITS EFFECT ON PERFORMANCE OF SMES IN UASIN GISHU

BY

RODGERS KIMUTAI MAIYO

A THESIS SUBMITTED TO THE SCHOOL OF BUSINESS AND ECONOMICS IN PARTIAL FULFILMENT FOR THE AWARD OF MASTERS OF BUSINESS ADMINISTRATION DEGREE (ACCOUNTING OPTION)

MOI UNIVERSITY

SEPTEMBER, 2019

DECLARATION

Declaration By Candidate

This thesis is my original work and has not been presented for a degree or any other award in any other university or educational institution. No part of this research proposal may be reproduced without the knowledge of the researcher.

Signature: _____   Date: _____

RODGERS KIMUTAI MAIYO

SBE/PGM/ELD/056/15

Declaration by the Supervisor

This thesis has been submitted with our approval as the university supervisors.

Signature: _____   Date: _____

DR. JOSPHAT CHEBOI

Dept of Accounting and Finance,

School of Business and Economics

Moi University

Signature: _____   Date: _____

DR. PATRICK LIMO

Dept Management Science,

School of Business and Economics

Moi University

DEDICATION

I wish to dedicate this work to my guardian for his moral support and encouragement throughout the entire process.

ACKNOWLEDGMENT

First and foremost I would like to pass my gratitude to my supervisors Dr Allan Simiyu and Dr Patrick Limo for tirelessly guiding me throughout the process, God bless you abundantly. Secondly, my appreciation also goes to all my family members for their financial and moral support they accorded me throughout the process.

Finally, I would like to acknowledge the support of my colleagues, Collins Kapkiyai, Edwin Kimitei, Allan Toroitich, Hillary Kiplagat and Neddy Soi, staff, lecturers of Moi University and fellow classmates for their assistance in one way or the other throughout the entire process.

ABSTRACT

SMEs performance is very crucial since they contribute significantly to economic growth and job creation around the globe. However, SMEs lack managerial capabilities, shortage in financing and human resources to cope with ever dynamic business environment which pushes them to outsource to improve their organizational performance. By relying on outsourcing, SMEs can obtain the capabilities and competences they require from external service providers. Therefore, the main aim was to assess determinants of decision to outsource accounting functions and its effect on performance of SMEs in Kenya. The specific objectives were: to determine the mediating effect of decision to outsource on the relationship between Trust, technical competence, resource availability and asset specification on SMEs performance. The study was informed by agency theory. The population of study comprised of 335 registered SMEs in Uasin Gishu County. This study adopted explanatory research design. Primary data were obtained from questionnaires. Cronbach's alpha was used to determine reliability, where Cronbach's coefficient having a value of more than 0.6 was considered adequate. Multiple regression model was used to test hypothesis. The findings showed a positive and significant effect of the determinants (manager's trust, technical competencies, resource availability and asset specification) on SMEs performance, $\beta = 0.8999$ p-value = 0.000. More specifically, the manager's trust has a positive and significant effect on firm performance ($\beta_1 = 0.220$) p-value = 0.000. Technical competencies has a positive and significant effect on firm performance ($\beta_2 = 0.250$) p-value = 0.000. Resource availability has a positive and significant effect on firm performance ($\beta_3 = 0.179$ while asset specification has a positive and significant effect on firm performance ($\beta_4 = 0.328$) p-value = 0.000. The regression model showed that the decision to outsource has a positive and significant effect on firm performance, $\beta = 0.1764$ p-value = 0.000. Accounting firms should have necessary resource to meet the ever increasing SMEs demands.

TABLE OF CONTENT

LIST OF TABLES

LIST OF FIGURES

OPERATIONAL DEFINITIONS OF TERMS

Outsourcing

Brian (2006) defines outsourcing as a contractual relationship between external vendors assuming responsibility of one or more business functions of an enterprise. It is a process of establishing and managing a contractual relationship with external suppliers (Momme, 2001)

Asset specificity

Rieple and Helm (2008) defines "asset-specificity as the degree to which an asset is valuable in the context of a specific transaction; this is relevant because of its interplay with opportunism". Asset specificity refers to specialized knowledge, language, skills and expertise concerning the specific characteristics of the enterprise, related to accounting functions (Everaert *et al*. 2010).

Performance

Firm performance refers to getting the outcomes of organizations' policies and operations in money matters (Verreynne and Meyer, 2008). The outcomes are seen in the organizations' return on investment, return on assets and value addition.

Trust

Trust in service providers is defined as one party believing to the other party based on the economic indication that the other party would carry out the commitment and act in a predictable way (Lee *et al*., 2008). Everaert *et al*. (2010) defined trust in the external accountant as the expectation of the owner/manager that the accountant;

(1) Can be relied upon to carry out legal commitments

(2) Will act in a predictable manner, and

(3) Will take action and negotiate fairly when the possibility for opportunism is present.

Technical competence

Having appropriate qualifications and experience, essential specialized skills, industry specialization and technological expertise (Carey *et al*., 2006).

Resources

Having better infrastructure and expertise necessary to carry out specific task.

ABBREVIATIONS

BPO   Business Process Outsourcing

CPA   Certified Public Accountant

GDP   Gross Domestic Product

IFAC   International Federation of Accountants

ILO   International Labour Organization

IT   Information Technology

KPMG   Klynveld Peat Marwick Goerdeler (accounting firm)

NSE   Nairobi Stock Exchange

OECD   Economic Cooperation and Development

SACCOs   Savings and Credit Cooperative societies

SMEs   Small and Medium size enterprises

TCE   Transaction Cost View

UK   United Kingdom

UNIDO   United Nation Industrial Development

US   United States

VAT   Value Added tax

CHAPTER ONE

INTRODUCTION

1.0 Overview

This chapter gives an in depth knowledge of the subject matter through the following heading; background information about the study, statement of the problem, objectives of the study, research hypotheses, significance and scope and of the study.

1.1 Background Information

Firm performance refers to the firm's success in the market, which may have different outcomes. It is a global phenomenon in business studies and it refers to getting the outcomes of organizations' policies and operations in money matters (Verreynne and Meyer, 2008). Enhanced firm performance is a way to satisfy investors and is always shown by profitability of business, growth and market value (Cho & Pucik, 2005). These three aspects complement each other. Profitability measures a firm's past ability to generate returns (Glick *et al*., 2005). Growth shows a firm's past ability to increase its size. Increasing size, even at the same profitability level, will raise its entire profit and cash generation. Bigger size also can bring economies of scale and market power, leading to greater impending profitability, hence performance. Market value signifies the external valuation and belief of firms' future performance. The highly competitive environment along with customers' demands for quality products and services has forced Small and Medium Size Enterprises (SMEs) and even companies to continuously evaluate, improve and reengineer their operations to enhance performance and remain competitive in business hence outsourcing its specialized services from professional (Razzaque and Sheng, 1998). World Bank defines SMEs as those enterprises with maximum of 300 employees, $15 million annual revenue and $15 million in Assets. In Kenya the Small and Micro enterprise Act of 2012 defines Micro

enterprise as one which employs less than10 people with annual turnover of not more than shs 500,000, while Small enterprise is one which employs between 11-49 employees and medium enterprise is one which employs between 50 and 150 people . Effective outsourcing services have become a critical issue for SMEs and even companies' performance (Razzaque and Sheng, 1998. Because of resource limitations, majority firms do not have the ability to apply world-class resources to all areas of competition. Thus, in order to gain competitive advantage they must select areas in which they will concentrate their resources and therefore outsourcing becomes very crucial. By outsourcing to specialist organizations services not generated by core competences, companies can see an improvement in their organizational performance (Cho and Pucik, 2005).

It is generally agreeable, based on evidence from practitioners and researchers, that small and medium enterprise (SMEs) are generators of employment and income in most developing economies which makes them very important for economic as well as social development (Samujh and Devi, 2008; OECD, 2009; IFAC, 2010). Extant statistics in many countries show that the SMEs are absolutely predominant. Basically most of these SMEs constitute more than 70% of all registered companies, and therefore have substantial influence on gross domestic product (GDP) and provide majority of employment opportunities.

While one may think that SMEs are developing-countries' phenomenon, recent empirical studies show that SME's contribute over 55% of GDP and over 65% of total employment in high-income countries. SMEs and informal enterprises, account for over 60% of GDP and over 70% of total employment in low-income countries, while they contribute over 95% of total employment and about 70% of GDP in middle-income

countries (Hidayet *et al.,* 2010). However, the dynamic businesses environment in the world have created disadvantages to the SMEs hence unable to compete competitively due to resource constrains since resource constraints generally are much more significant for SMEs than they are for large firms (Marriott and Marriott, 2000).The challenges that SMEs and other businesses face in sustaining competitive advantage in the corporate world have become a major global concern (Dorasamy *et al.,* 2010). Hence, business management has become more complicated and business need to rethink to cope with the dynamic business environment to remain in business (Rodrigue, and Robaina, 2004). In such business environment, the sustainability of many Small and Enterprises (SMEs) is threatened and therefore face significant challenges due to resource constraints (Kamyabi, and Devi, 2011).

Indeed, most of SMEs has a tendency of fail because of lack of planning, knowledge, absence of overall managerial skills, competencies and resource constrains (Dyer and Ross, 2008). Many SMEs lack skilled accounting personnel and the infrastructure necessary to implement existing accounting rules and regulations (United Nations Conference on Trade and Development, 2000). Furthermore, SMEs lack access to expertise because accounting functions require not only knowledge of generally accepted accounting rules or tax regulations but also a knowledge of how to apply the rules in a given business environment (Everaert *et al*., 2006).

To overcome such challenges, it is suggested that SMEs should outsource their activities by shifting what they traditionally handled in-house (Kotabe and Mol, 2009) and particularly, those activities that require special knowledge for example accounting. Businesses globally are adopting strategies that help them reduce cost and remain competitive in a very dynamic business environment, for example outsourcing of

external accountant who provide professional accounting services (Everaert *et al,* 2016). Outsourcing is a business practice of contracting out business processes to a third party or to an external source (Longenecker *et al.,* 2003; Rodriguez and Diaz, 2008) and hence involves the transfer of responsibility (Krell, 2006). SMEs have to reduce their costs and create new opportunities through optimized utilizing of external resources (Mahmoodzadeh *et al.,* 2009). As organizations shift their focus towards their core competencies, the outsourcing of less critical functions to a third party is becoming an attractive option (Longenecker *et al.,* 2003). It has been suggested that efforts to rethink business strategies to focus them on core competencies are the fundamental reason for the increasing popularity of outsourcing practices. However, prior work by researchers suggests that US companies pursue outsourcing to gain more value-adding sourcing, whereas UK companies use outsourcing to develop economies of scale (Kakabadse and Kakabadse, 2002). These results run contrary to the data collected using a survey by Zarrella and Huckhai (2004) from KPMG, in which it emerged that Asia Pacific companies are outsourcing even their core business operations.

Based on the Business Process Outsourcing (BPO), it appears that 33% of core business operations were outsourced during the period under study. The survey by Zarrella and Huckhai (2004) from KPMG also revealed that 95% of Asia Pacific companies outsource some component of either or both business process or IT functions. Whereas organizations see outsourcing as a tool used to increase efficiency and effectiveness in the process of improving business performance, the recent literature on outsourcing shows that cost reduction is the most critical reason for outsourcing (Kakabadse and Kakabadse, 2002).

In view of the decision on the outsourcing of various types of business functions, it seems that the outsourcing of accounting functions is evidently increasing (Ya Ni and Bretschneider, 2007). In Australia, Carey *et al.* (2005) found 67% of SMEs use external accountants as a source of professional services and also indicate that there is room for external accountants to enhance the amount of advisory services to SMEs. According to (OAOI) (2007) switching to outsourcing of accounting enables companies to reduce overhead and focus on their core business activities, this improve growth and performance of SMEs for example outsourcing accounts payable improves accountability, reduces cost and effort in the SMEs which stimulate growth and hence performance of this businesses. By outsourcing tax processing, SMEs can save time and avoid penalties arising from late payment and filing returns. SMEs can stay free from the pressure or keeping track of changing laws and the latest technology (OAOI, 2007). Due to resource constrains SMEs cannot access professional accountants, outsourcing enable them to access this services, hence accurate information which enable them to make accurate decisions, this improves their performance.

Companies often outsource work in areas that require specialized knowledge or a significant number of hours, such as payroll processing and payroll tax preparation. Krell (2006) has mentioned that some components of accounting functions are suitable to be outsourced such as general ledger, financial reporting and internal services. The abstraction of elements of business outsourcing for operations finance and accounting services are as follows: General accounting, Auditing, Accounts payable, Credit services, insurance processing, Tax Services, Billing systems Accounts receivable, Collections and credit Compliance Management Reporting. Outsourcing some or all accounting functions also can be beneficial if it matches up with your organization's needs and its budget (Cohen and company ltd 2016). Accounting services and functions

play a very important role in the lives of SMEs, because they provide better management control, assist in decision-making, help to access new market and maximize profits in the corporate world (Dorasamy *et.al*, 2010).

External accountants can assist SMEs operating in a competitive environment, to integrate operational considerations within long-term plans to enhance their sustainability. Furthermore, in more complex conditions, external accountants are in a unique position to provide approaches and assist SME owner/managers to achieve their business objectives (Devi and Samujh, 2010). Moreover, Stanger (2004) found that external accountants are generally the most used source of professional services for small firms. (Berry *et al.,* 2006) in his study observed that external accountants were a very significant source of professional services. Gooderham *et al.,* (2004) investigate factors associated with small firms relying on their external accountant as a business advisor and they suggested that most small firms rely on their external accountant as business advisor. Furthermore, Sian and Roberts (2009) found 57.2% of small firms outsourced accounting services including financial statements (51.1%), tax or Value Added Tax (VAT) information (30.8%) and accounting system (18.1%). Jayabalan *et al*. (2009) found that the types of accounting functions outsourced are based on the standard functions which include bookkeeping, accounts receivable, accounts payable, financial reporting, management reporting and tax filing.

Everaert *et al*. (2007) revealed that more than half of SMEs use a combination of outsourcing and insourcing of accounting functions, while 35% of the SMEs use only in-house accountants' services and 12% use total outsourcing of accounting services. In the UK, Berry *et al*. (2006) found 85% of small enterprises used their external accountant as a source of advice. In the UK and Canada, Blackburn *et al*. (2006) report

that SMEs use accountants more than any other single source as their main provider of advice in relation to dealing with their regulatory obligations.

Agency theory has become a standard framework of explaining owners/managers relationship with external service providers (Eisenhardt, 1989), while Transaction cost economics (TCE) theory explain why some firms choose to have an internal accounting department undertaking its function internally, while other firms decide to outsource that function to a professional accountant (Everaert *et al*., 2010.). agency theory explains trust in external accountant/risk of accounting are critical factor influence accounting outsourcing (Everaert *et al.,* 2010.) while Transaction Cost Economies (TCE) help to analyze asset specificity, firms' resources and capabilities for example technical competence and resource availability, which will connect outsourcing to firm performance (McIvor, 2009). TCE theory would indicate that outsourcing by smaller firms should create lower costs (e.g. employment, payroll and training) than when those functions are performed in-house because smaller firms lack of competences that result from scale and experience effects (Gilley *et al*., 2004). On the other hand, Agency theory states that long term relationships with vendors may in the long run lead to higher effectiveness, due to the stability of the relationship being dependent on controlling goal conflicts. Sharma, (1987) has extended the agency theory and focuses on the principal-professional relationship, where professionals can include accountants (Sharma, 1987). Agency theory can also assist in analyzing SME capabilities, which can link outsourcing with performance (McIvor, 2009). Further, TCE can enhance our understanding of whether it is more suitable to insource or outsource a function from external service providers (Stratman, 2008).

Many claim that association between outsourcing and trust in external servicer should be analyzed based principal-agent relationship (Greenberg *et al.,* 2008). Trust between the firm and external service provider reduces Agency costs of by diminishing threat of opportunism or otherwise removing agency conflict. Agency theory supports the view that when there is trust, agency conflict diminishes and a long term relationship is build which improves efficiency and effectiveness hence increase in performance of the firm Jones (1995). Overall, the higher the perceived trust in professional accountants, the higher is the likelihood that the owner-managers of SMEs will choose to outsource their management accounting functions (Everaert *et al.,* 2010).

One of the objectives of the TCE is to help SMEs realize why technical competences can be perceived as a firms' most valuable asset and understand how those assets can be used to improve firm performance (Caldeira and Ward, 2003). If SMEs outsource accounting functions and concentrating on core activities, this will enhance firm performance (Gilley *et al*., 2004; Espino Rodríguez and Padrón-Robaina, 2004). Attributes of technical competence to an accountant include appropriate qualifications and experience, essential specialized skills, industry specialization and technological expertise (Carey *et al.,* 2006). The largest parts of SME owner/managers have no professional, management and other formal qualifications (Kamyabi and Devi, 2011).

Indeed, external accountants' services to their SMEs can summarize a range of competencies providing an important source of competitive benefit (Gooderham *et al*., 2004). One possible way for a smaller firm to obtain competencies is to utilize qualified persons (Gooderham *et al*, 2004). Therefore, by relying on outsourcing, smaller firms can obtain the competence they need from external service providers (Gilley *et al*., 2004). Moreover, the reliance by SMEs on external accountants is indicated to be a

result of the perceptions of SMEs that external accountants are competent and able to provide a value-for money service in providing accounting services (Leung *et al*, 2008). According to TCE, when asset specificity is low, and transactions are relatively frequent, transactions might be governed by outsourcing (Watjatrakul, 2005; Jiang *et al*., 2007; Chang *et al*., 2009). In other words, higher levels of asset specificity would lead to a lower amount of the core businesses being outsourced (Chang *et al*., 2009; Jiang *et al*., 2007). However, human asset specificity is an important driver for the outsourcing in internal audit function (Spekle´ *et al*., 2007), and accounting services (Everaert *et al*., 2010). Therefore, Everaert *et al*. (2010) found that outsourcing of accounting tasks is significantly associated with asset specificity.

Better performance may be obtained by outsourcing (Gilley *et al*., 2004). On one hand, by outsourcing human resources to external sources, firms may achieve superior levels of employee performance and productivity, thus leading to higher financial performance (Gilley *et al*., 2004). On the other hand, by outsourcing functions or tasks, SMEs would be able to focus on the value-creating functions that drive competitive benefit (Gilley and Rasheed, 2000). Hence, outsourcing of services enables a firm's capabilities to be improved by external professional accountants (Shang *et al*, 2008). Therefore, a major concern of the TCE is how a firm's capabilities develop and affect its performance (McIvor, 2009). In actual fact, the outsourcing decision is influenced by the ability of an enterprise to invest in developing a capability and sustaining a superior performance position in the capability corresponding to competitors (McIvor, 2009).

Limited studies examined the effect of the advisory services of external accountants on SME performance (Berry *et al*. 2006; Bennett and Robson 1999). In addition, research

in SME context with respect to outsourcing of accounting functions is growing (Everaert *et al*., 2010; Everaert *et al.,* 2007; Doran, 2006; Carey *et al.,* 2006), but less research conducted in developing countries while they overlook the link of outsourcing to SME performance (Jayabalan *et al.,* 2009). Furthermore, empirical evidence from studies on developed countries may not be as relevant to developing countries such as Kenya (Mashayekhi and Mashayekh, 2008). While there has been research of outsourcing effects on performance in general, no empirical research has particularly addressed determinants of outsourcing of accounting functions by SMEs.

1.2 Statement of the Problem

SMEs performance is very crucial since they contribute significantly to economic growth and job creation around the globe, and therefore their role in both developed and developing economies cannot be under estimated (OECD, 2004). However, business environment is unstable and unpredictable as result of economic globalization, technological changes, change in customer expectation and increasingly demand and stiffer competition, hence majority of SMEs in emerging economy cannot compete in an effective way due to their internal resource gap (UNIDO, 2003; ILO, 2003; IFAC, 2010). This is because SMEs lack managerial capabilities, shortage in financing and human resources to cope with the dynamic business environment which pushes them to outsource to improve their organization, Hasnah *et. Al* 2011), (Dorasamy *et al*. 2010, Ismail, 2002.

By relying on outsourcing, SMEs can obtain the capabilities and competences they require from external service providers (Gilley *et al.,* 2004). This becomes advantageous to audit firms to extend their services particularly accounting functions to meet business needs of the SMEs (Hasnah *et. al*, 2011). However, these audit firms

or external accountants may not have capacity to provide these accounting activities because of increased demand for external accountants, lack adequate staff to cope with the increased workload and SMEs owners or managers may not trust them, hence may adversely affect their performance (Susela & Helen, 2010).

Studies have been done on outsourcing of different functions within firms in Kenya. (Lutta 2003) carried out a study on outsourcing of distribution logistic within supply chain of East Africa Breweries Ltd. The study clearly revealed that the outsourcing of distribution logistics was successfully implemented in a phased approach and in some cases it was a "sudden event". Kipsang (2003) did a study on outsourcing of information technology services by commercial banks in Kenya. The research done revealed that 25commercial banks (which are 73.5%) were not keen on outsourcing their IT functions to a greater extent for their concern on data security as well as exposure of critical customer information. Kamar (2015) researched on implementation of business process outsourcing by government agencies under the ministry of information and communications technology in Kenya. The study concluded that business process outsourcing has positive effects in organizations. A research by Masinga E. *et al* (2014) on effects of outsourcing decision on organization performance in the manufacturing industry found that there is a significant relationship between the predictor information technology adoption, top management support and commitment, focus on core competencies and cost reduction (taken together) and organization performance in Kenyan manufacturing firms. Joseline (2015) did a study on effect of outsourcing of accounting functions on performance of SACCOS. She found that outsourcing, liquidity and Managerial quality do not significantly affect the performance of SACCOs. Weru (2006) did a study on the outsourcing of accounting services among firms listed in Nairobi Security Exchange (NSE) and concluded that a similar study

ought to be carried out on non-quoted companies to determine how outsourcing of accounting services can be used to benefit through improved efficiency and reduced cost. Based on the above past studies it is clear that there has been limited studies which have empirically tested the link between the three concept i.e. determinants of outsourcing, outsourcing decisions, and SMEs performance, and if there are, few have been done in Kenya, hence a gap in the existing literature and need to carry out this study.

1.3 General Objective

The main aim of this study was to assess determinants of decision to outsource accounting functions and its effect on performance of SMEs in Kenya.

1.3.1 Specific objectives

 i. To determine the effect of owners/managers Trust in external accountant on the on SMEs performance

 ii. To determine the effect of technical competence of the firm on the SME performance.

 iii. To determine the effect of resource availability on SMEs performance

 iv. To determine the effect of Asset specification on the SMEs performance

 v. To determine the mediating role of decision to outsource on,

  a) the effect of manager/owners trust on performance of SMEs

  b) the effect of technical competence of the firm on performance of SMEs

  c) the effect of resource availability on performance of SMEs

  d) the effect Asset specification on performance of SMEs

1.4 Hypotheses

H_{O1}:   There is no significant effect of trust on decision to outsource among SMEs.

H_{O2}:   There is no significant effect of technical competencies on decision to outsource among SMEs.

H_{O3}:   There is no significant effect of resource availability on decision to outsource among SMEs.

H_{O4}:   There is no significant effect of Asset specification on decision to outsource among SMEs.

H_{O5a}:   Outsourcing decision does not mediate the relationship between trust in external accountant and performance of SMEs

H_{O5b}:   Outsourcing decision does not mediate the relationship between technical competencies of the firm and performance SMEs

H_{O5c}:   Outsourcing decision does not mediate the relationship between resource availability and performances of SMEs

H_{O5d}:   Outsourcing decision does not mediate the relationship between Asset specification and performance of SMEs

1.5 Significance of the Study

Results and suggestions from study which was carried out in Kenyan context can be utilized by managers/owner of SMEs on how they can enhance   their sustainability in the 21th century's dynamic business environment. Management of businesses is becoming more and more complex due to globalization, ever changing customers'

needs and competition. Therefore, businesses need utilize strategies that will hold them in business, this research therefore will be utilized by SMEs and other business model to come with strategies which help them gain competitive advantage as business environment change.

The nature of accounting functions are people-intensive and SMEs lack people and capability or competence, so this study provides comprehensive actions plans to garner the existing capabilities of professional accountants in serving the SME in Kenya.

SMES contribution to economic growth and job creation cannot be under estimated, this research therefore, will assist the government in coming up with policies that promote the growth of SMES in Kenya. The government can identify the critical gaps in its policies and work towards filling the gaps for better growth and sustainability of SMES in the general growth of the economy.

This study is hoped to generate new knowledge that widen horizons of existing knowledge concerning determinants of outsourcing accounting functions and its effect on SMES performance. It is hoped that conclusions that will be drawn and recommendations that will be made will be of use to owners, managers, external service providers, advisors and decision-makers associated with enhancing growth and sustainability of SMES in Kenya.

1.6 Scope of the Study

The study targeted SMEs based in Uasin Gishu County which is located in North Rift, Rift Valley Province of Kenya the study area was chosen due to the rising number of small and Medium-enterprises to which enabled the researcher to get a large target population which also translated to large sample size which supports generalization of

research findings. The population of study comprised 1053 registered SMEs where owners/managers in Eldoret Town, Uasin Gishu County (Company Registrar, 2015). The study only targeted SMEs within seven sectors, namely; financial services, Retail, Telecommunication, Agriculture, Hospitality, Professional services and Workshop services. The study used four determinants which include trust, technical competencies, resource availability and Asset specification. The respondents in this study were the owners and the employees. The study was conducted within a period of 4 months (February – May, 2017).

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter provides the reader with an in-depth knowledge on the existing literature on determinants of outsourcing of accounting function and its effect on SMEs performance. The chapter will also look at theories that inform the research and the conceptual framework.

2.1 Concept of Outsourcing

Outsourcing can be defined as strategy by which major non-core functions of an organization are transferred to specialists, efficient external providers. Brian (2006) defined outsourcing as a contractual relationship between external vendors assuming responsibility for one or more business functions of the enterprise. Another definition provided is one well suited for all institutions which includes, contracting with private vendors for provision of services or the management of in-house staff and resources to provide needed services, selling franchises, using vouchers, selling assets, public-private partnering, allowing private enterprises to fill certain voids, and creating in house businesses that provide the services to institutional units on a full-cost fee basis (Leftwich and Inhofe, 2001). Further definition elaborates the economic advantages of outsourcing as a business function. Momme, (2001) in his study argues that outsourcing is the process of establishing and managing a contractual relationship with an external supplier for the provision of capacity that has previously been provided in-house. Outsourcing can be defined as management strategy by which major non-core functions of an organization are transferred to specialists and efficient external providers. This is according to Brian, (2006) who defined outsourcing as a contractual relationship

between external vendors assuming responsibility for one or more business functions of the enterprise.

According to Hunt, (2000), Outsourcing is a strategic decision that entails the external contracting of determined non-strategic activities or business processes necessary for the manufacture of goods or the provision of services by means of agreements or contracts with higher capability firms to undertake those activities or business processes. The purpose of outsourcing is to improve competitive advantage.

Targett, (2000) in his study asserts that the reason for outsourcing can vary, but most of the reasons focus on several basic considerations. One reason is that outsourcing allows a company to improve return on investment. This is because the outsourcing company is able to reduce its assets for example in IT, warehouses or equipment. Many companies also expect reductions in operating costs. Surveys that asked companies for the reasons of outsourcing, show that costs and pricing are almost always among the top three determinants.

Another consideration is that the company has to improve its focus on its core business. Quality and shorter lead times are two other main and often mentioned reasons for outsourcing. These are very important criteria for manufacturing companies since shorter lead times will result in less in-transit inventory and shorter time to market. A reasonable quality compared to the price is another important factor for differentiating from competitors and for gaining and maintaining customers (Barthélemy, 2003).

Geyer, (2005) in his study found out that outsourcing can be looked at from three different levels; tactical, strategic and transformational. Tactical level of outsourcing means that a company will get better service for less investment and management time

from an outsource provider. This focuses on constructing the right contract and making the vendors stick to that contract. The important reason for tactical outsourcing is immediate cost saving. Most companies use tactical outsourcing as a direct way to address cost problems. This outsourcing is most likely executed from the purchasing department.

Strategic outsourcing is about outsourcing a certain function of a company in order to focus on core businesses. It requires a strong secure relationship between the vendor and the company that is a strategic long-term partnership with the emphasis of mutual benefit, instead of a pure vendor buyer relationship. Therefore, the focus is on building long-term value from working with a small number of best-in-class integrated service providers instead of a large number of vendors (Click, 2005).

The concept of outsourcing came from the American terminology "outside resourcing", meaning to get resources from the outside. The term was later used in the economic terminology to indicate the use of external sources to develop the business, which typically were using their internal resources (Victor, 2012). In the literal sense, outsourcing denotes utilization of external resources. It occurs when the execution of tasks, functions and processes hitherto fulfilled in-house is commissioned to an external provider specializing in a given area on the basis of long-term co-operation. In accounting, the process of outsourcing involves the 'external accountant,' including both the professional accountant in one hand and the accounting firm on other hand (Everaert *et al*., 2010). For instance, in Kenya, external accountant refers to both the professional accountant and the accounting firm with valid practicing certificates can hold themselves out as CPA, and set up firms providing auditing services (e.g. tax audit and financial audit), accounting services (i.e. accounting systems planning, product /

services costing, financial statement), advisory services (e.g. tax advice) (Naderian, 2010).

Empirical studies revealed that most of SMEs outsource accounting activities to external accountants. For instance, in Belgium SME sector, Everaert *et al*. (2006, 2007, 2010) reported that over two-third of SMEs outsource accounting tasks to external accountants. In Australian, Carey *et al*. (2006) claim many firms outsource internal audit functions to external accountants. In Norway, Gooderham *et al*. (2004) indicated that many smaller firms engage external accountant as provider of support services. In the UK, a number of empirical studies reported that majority of SMEs use external accountants' services (Berry *et al*., 2006; Scott and Irwin, 2009; Sian and Roberts, 2009). In Malaysia, Jayabalan *et al*., (2009) assert majority of SMEs outsource accounting activities to external accountants.

According to [OAOI] (2007) switching to outsourcing of accounting enables companies to reduce overhead cost and focus on their core business activities, this improve growth and performance of SMEs for example outsourcing accounts payable improves accountability, reduces cost and effort in the SMEs which stimulate growth and hence performance of this businesses. Outsourcing accountants can assist SMEs operating in a competitive environment, to integrate operational considerations within long-term plans and to enhance their sustainability. Furthermore, in more complex conditions, external accountants are in a unique position to provide approaches and assist SMEs owner/managers to achieve their business objectives (Martin, 2005; Devi and Samujh, 2010). Outsourcing of accounting functions is determined by Trust in external accountant, Technical competence, Resource availability and Asset specification.

2.2 The Concept of SME Performance

Firm performance refers to the firm's success in the market, which may have different outcomes. Firm performance is a focal phenomenon in business studies. Firm performance refers to getting the outcomes of organizations' policies and operations in money matters (Verreynne and Meyer, 2008). The outcomes are seen in the organizations' return on investment, return on assets, value added. How organizations perform is mostly the contentious issue in much research work that has been done. The main concern for this work is to identify the key issue that may drive firms into a greater competitive advantage therefore improving the returns of the firm. Throughout the past period, the main factor in addressing profits hence firm performance However, it is also a complex and multidimensional phenomenon.

The concept of firm performance implies measuring the results of a firm's policies and operations in monetary terms. These results are reflected in the firm's return on investment, return on assets, value added. Performance differences in firms are often the subject of academic research and government analysis (Verreynne and Meyer 2008). The underlying motivation for this kind of research is the quest for those factors that may provide firms with a competitive advantage and hence drive firm profitability. Traditionally, the emphasis in analyzing variations in firm performance has been at the industry level, implying that the structural characteristics of an industry ensure substantial homogeneity among firms within that industry and as a result determine to a large extent firm performance. However, despite the attention for and importance of the topic, defining a specific industry has always been a subject of discussion.

Enhanced firm performance is a way to satisfy investors and is always shown by profitability, growth and market value (Cho & Pucik, 2005). These three aspects

complement each other. Profitability measures a firm's past ability to generate returns (Glick *et al.*, 2005). Growth shows a firm's past ability to increase its size. Increasing size, even at the same profitability level, will raise its entire profit and cash generation. Bigger size also can bring economies of scale and market power, leading to greater impending profitability. Market value signifies the external valuation and belief of firms' future performance. It ought have a relationship with historical productivity and progression levels, but also incorporate future expectations of market changes and competitive moves.

2.3 Theoretical Framework

2.3.1 Agency Theory

An agency relationship is one in which "one or more persons (the principal[s]) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. Perhaps the most recognizable form of agency relationship is that of employer and employee. Other examples include state (principal) and ambassador (agent); constituents (principal) and elected representative (agent); organization (principal) and lobbyist (agent); or shareholders (principal) and CEO (Eisenhardt, 2009; Rungtusanatham *et al.*, 2007). The function and rule of the principal (manager) and agency (client) is very important in achieving high performance in Small and medium Size enterprise (SMEs) Jensen (2002). If the agent is rewarded by the principal on a basis which does not correlate his/her effort to the reward, the agent may not have the incentive to exercise the highest effort. The costs resulting from this agency problem includes both the loss of potential benefits and the costs of measures designed to reduce the loss of potential benefits. *Michael Jensen* and *William Meckling* (1976) identified these costs and termed them agency costs.

But economic analysis suggests that internalizing some of these market transactions into a firm may substantially reduce the risks of opportunism. But despite reducing some of the costs of opportunism in the market, the special structure of the firms creates other forms of opportunism in those entrusted with economic responsibility to manage the firm.

The important assumptions underlying agency theory are that; potential goal conflicts exist between principals and agents; each party acts in its own self-interest; information asymmetry frequently exists between principals and agents; agents are more risk averse than the principal; and efficiency is the effectiveness criterion. The application of the theory in the outsourcing process research was in the Preparation Phase when screening for vendors and defining its own attitude towards the type of the relationship. Naturally, the Managing relationship phase has been also explored, and to a very small extent the Reconsideration phase. All these center on principal trust towards external service provider (Zoran, 2007).

Agency theory is most relevant in situations where contracting problems are difficult and trust is more essential in the relationship. These include situations in which there is a substantial goal conflict between principals and agents and which may trigger substantial risk implications outlined by the theory (Eisenhardt, 1989). Eisenhardt discusses the assumptions of the theory and raises the issue of principals learning about the agents when there is a long term relationship, when there may be less need for outcome -based contracts.

Jones (1995) suggests that long term relationships with vendors may in the long run lead to higher effectiveness, due to the stability of the relationship being dependent on controlling goal conflicts. Sharma, (1987) has extended the agency theory and focuses

on the principal-professional relationship, where professionals can include consultants and even accountants (Sharma, 1987). It is common for public entities to use consulting houses in specifying requirements and even in the tendering phase and the selection of vendor.

Sharma, (1987), argues that, there are some specific distinctions of the principal-professional agency exchange. The greatest is the power asymmetry. In an owner-manager or manager-worker relationship, the principal have the power to design and enforce contracts and hence the power to enter or to dismiss incentives for the managers and the workers. In contrast, principal -professional exchanges are inherently those in which professionals has the power over lay principals by virtue of their expertise, functional indispensability, and intrinsic ambiguity associated with the services they provide Jensen (2002). It also involves a considerable information asymmetry; the principal does not only not know how the professional agent does the job, but also not what he or she does. This information asymmetry also makes it difficult for the principals to know beforehand how much service is actually needed. In this kind of scenario long lasting relationship build on trust becomes essential in order for the firm to improve its performance and be able to competitively compete in the market Michael J. and William M. (1976).

2.3.2 Transaction Cost Theory

The transaction cost economics theory, (TCE) developed by Coase (1937) has been used to study outsourcing of firm activities. TCE is predominantly concerned with economizing on transaction costs. It focuses on specific phenomena, of which vertical integration (the make-or-buy decision) is the paradigm problem Williamson (2007).

This theory has received attention by the outsourcing literature since it explains why some activities are retained inside firm boundaries while others are outsourced. Williamson's concept of transaction costs offers a tentative explanation as to why a firm should choose either to manage firm activities within the firm, or by means of transaction in the market place. When the transaction costs for an activity is lower than the costs of producing within the firm, it would be preferably outsourced. According to Williamson (1979), activities should be retained within organizational boundaries under conditions of uncertainty, asset specificity and continual reconstructing. There are two types of costs: production and transaction costs. While outsourcing reduces production costs, it also has the potential to increase transaction costs of an activity. Transaction costs are composed of many different costs such as searching and negotiating with partners and cost of monitoring and enforcing the contract (Agarwal and Ramaswami, 1992; Erramilli and Rao, 1993; Makino and Neupert, 2000).

This theory suggests that only when transaction costs of market exchange are greater than the benefits of externalization, then internalized operations are preferred (Brouthers, 2002; Hennart, 1991). Pisano (1990) used this perspective to examine external sourcing of R&D, concluding that small number- bargaining motivated internalization of R&D. This conclusion was supported by Kay (1979) and Teece (1988). Both Teece and Kay argue that R&D is usually done more efficiently in-house for several reasons. For example it is difficult to specify contracts due to high technological, market and general business uncertainty, the protection of proprietary information is difficult, and cumulative learning processes are important to make the lasting strategic advantage of the firm stronger. The transaction cost perspective is however questioned by Chesnais (1988) as it makes collaboration in the production of technological knowledge difficult to explain. Undoubtedly, transaction cost economics

(TCE) (Williamson, 1975) has made key contributions to the understanding of make-or-buy decisions, although its limitations have also been highlighted (Barney, 1999; Marshall *et al*., 2007). Asset specificity has been shown to be a key determinant of make-or-buy decisions (Leiblein, 2003; Walker and Weber, 1984; Williamson, 1981). The lower the asset specificity of an activity, the easier it becomes to write complete contracts and the more likely is outsourcing. Uncertainty has similarly been identified as a determinant of the make-or-buy decision (Williamson, 1981). Firm capabilities and resources are a firm-level indicator of what can and cannot usefully be outsourced (Barney, 1999).

TCE focuses on the role of efficient governance (insourcing or outsourcing). It describes that asset specificity (i.e. knowledge, language and skills) and trust in a professional (for example accountant, auditor, Hrm etc.) are important factors that influence outsourcing decision (Lamminmaki, 2005; Watjatrakul, 2005; Spekle´ *et al*., 2007; Everaert *et al*., 2010). Asset specificity should be analyzed from the perspective of TCE (McIvor *et al*., 2009; Watjatrakul, 2005).

Trust in the service provider is one of the significant drivers that affect outsourcing decisions (Brouthers and Brouthers, 2003). Consistent with TCE, corporate strategy is another factor that can affect a firm decision to outsource services to an external provider because the company can concentrate on the core competencies of a business (Carey *et al*., 2006). Indeed, in practice, outsourcing decision is influenced by both Agency theory and TCE considerations (McNally and Griffin, 2004).

2.4 Trust in External Accountant and Decision to Outsource

Trust in service providers is defined as one party believing to the other party based on the economic indication that the other party would carry out the commitment and act in

a predictable way (Lee *et al*., 2008). Everaert *et al*. (2010) defined trust in the external accountant as the expectation of the owner/manager that the accountant (1) can be relied upon to carry out legal commitments, (2) will act in a predictable manner, and (3) will take action and negotiate fairly when the possibility for opportunism is present. Trust between the firm and external service provider reduces the costs of transaction by diminishing threat of opportunism [Greenberg, *et al* 2008). For instance, if the professional accountant and the management of the SME sustain a trust-based relationship, opportunism will not be of concern (Greenberg, *et al* 2008, Hansen, and Morrow, 2003).

Trust turns to a situation where one party (firm) relies on the other party (service provider) based on the economic indication that the other party would carry out the commitment and act in a predictable way (Lee, Huynh and Hirschheim, 2008). Agency theory perspective also extends personal characteristics such as management's trust in its service provider as critical factor in outsourcing (Brouthers and Brouthers, 2003; Hansen and Morrow, 2003; Verwaal *et al*., 2008). Trust is as an expectation that another party (supplier) does not act in an opportunistic manner (Gainey and Klaas, 2005). Jones (1995) suggests that long term relationships with vendors may in the long run lead to higher effectiveness, due to the stability of the relationship being dependent on controlling goal conflicts. Sharma, (1987) has extended the agency theory and focuses on the principal-professional relationship, where professionals can include audit firms (Sharma, 1987). When trust develops, both parties (firm and external service provider) feel confident in their relationship and the opportunism will be decreased due to reliance in their ability to perform a function (Greenberg *et al*., 2008; Bozzurro, Costa and Zhang, 2008). However, when trust diminishes there will be a substantial goal conflict between principals and agents and sufficient outcome is uncertainty which triggers risk

implications of the theory (Eisenhardt, 1989). Eisenhardt discusses the assumptions of the theory and raises the issue of principals learning about the agents when there is a long term relationship, when there may be less need for outcome -based contracts. If the agent is rewarded by the principal on a basis which does not correlate her effort to the reward, the agent may not have the incentive to exercise the highest effort. The costs resulting from this agency problem includes both the loss of potential benefits and the costs of measures designed to reduce the loss of potential benefits.

Threat of opportunism is indicative of a lack of trust that an outside service provider will honestly fulfill task or project obligations (Ghoshal and Moran, 1996). The greater this threat, the greater the degree to which a firm (client) has to employ complex and costly governance mechanisms to safeguard its interests in its transactions with an external service provider (Dyer, 1996). Accordingly, the managements of the firms are expected to outsource activities only if they understand that they are sufficiently protected from the service provider's opportunistic behavior (Tiwana and Bush, 2007). Therefore, trust of a firm in its external service provider reduces transaction costs by reducing the perceived threat of opportunism (Dyer and Chu, 2003). Such trust in an external service provider is a project-specific feature that may arise from external service provider's reputation (Sabherwal, 1999). Therefore, trust in the service provider was suggested to be the central mechanism which is consistent with agency theory of which takes on specific forms and is employed in specific relationships to each other (Bachmann, 2001; Gainey and Klaas, 2005). Thus, based on Agency perspective, trust has been recognized as a tremendously important mechanism in outsourcing decisions (Bachmann, 2001; Hansen and Morrow, 2003; Tiwana and Bush, 2007; Greenberg *et al*., 2008; Verwaal *et al*., 2008).

Many claim that the association between outsourcing and trust in external service provider should be analyzed based on Agency theory (Brouthers and Brouthers, 2003; Everaert *et al*., 2010; Greenberg *et al*., 2008). Accordingly, Agency theory supports the view that when there is trust, the formal control mechanisms may be reduced and firm tends to outsource their service reduces firms' break-even points and these enhance the functions. Kim *et al*. (2007) indicated that trust is key significant driver affecting outsourcing. Everaert *et al*. (2010) indicate that the SME's decision to outsource accounting services is based on the characteristics of the transaction and the interpersonal trust of the owner/manager in the external accountant. Overall, the higher the perceived trust in professional accountants, the higher is the likelihood that the owner-managers of SMEs will choose to outsource their management accounting functions.

Agency theory describes that trust in professional accountant is an important factor which influence outsourcing decision (Lamminmaki, 2005; Watjatrakul, 2005; Spekle´ *et al*., 2007; Everaert *et al*., 2010), thus the function and rule of the principal (manager) and agency (client) in outsourcing decisions is very important in achieving high performance in Small and medium Size enterprise (SMEs) Jensen (2002).

2.5 Technical Competence and Decision to Outsource

Technical competence is the most valuable asset in an organization because owners use to improve organizational performance (Caldeira and Ward, 2003). By outsource the functions that are not core competences, SMEs can concentrating on activities not included in the core competences hence enhance their firm performance (Gilley *et al*., 2004; Espino Rodríguez and Padrón-Robaina,2004). Attributes of technical competence to an accountant include appropriate qualifications and experience,

essential specialized skills, industry specialization and technological expertise (Carey *et al*., 2006). The largest parts of SME owner/managers have no professional, management and other formal qualifications (Kamyabi and Devi, 2011). Indeed, external accountants' services to the SMEs can summarize a range of competencies providing an important source of competitive benefit (Gooderham *et al*., 2004). One possible way for a smaller firm to obtain competencies is to utilize qualified persons (Gooderham *et al*, 2004).

Therefore, by relying on outsourcing, smaller firms can obtain the competence they need from external service providers (Gilley *et al*., 2004). Moreover, the reliance by SMEs on external accountants is indicated to be a result of the perceptions of SMEs that external accountants are competent and able to provide a value-for money service in providing accounting services (Leung *et al*, 2008). Many of SME owner/managers lack financial skills and knowledge of how financial control systems might be utilized to aid decision-making (Deakins *et al*., 2001). For instance, the functions involved providing advisory services on internal planning, decision-making and control, that is, in areas where a SME owner/manager often lacks competence (Gooderham *et al*, 2004). Hence, SMEs rated very highly the technical competence of external accountants concerning regulation matters (Blackburn *et al*, 2006). It is predicted that perceptions of external accountants' technical competence will influence the decision to outsource accounting tasks (Carey *et al*.2006).

Firms always thrive to build its ability to develop new products or services enabling it to go into new markets which is being dependent on its possession of superior resources. In most cases, because of resource constrains and increased competition, SMEs cannot afford to have professional services in-house but rather they outsource (Døving and

Gooderham, 2008). In outsourcing, especially professional services SMEs the considers an external firm's possession of valuable resources such as competencies which is very important determinant of a firm's capability to pursue economies of scope (Barney, 1986; Penrose, 1959; Wernerfelt, 1984). The concept of the competence derived by Hamel and Prahalad (1994) has influenced significantly outsourcing decisions. One of the objectives of the agency theory is to help owner/managers and external service providers realize why competence is perceived as a firms 'most valuable asset, and to understand how those assets can be used to improve firm performance (Caldeira and Ward, 2003).

Competencies are skills, knowledge, and technological expertise that a firm needs to possess or obtain from external sources (McIvor, 2000). However, in the accounting context, technical competence of external accountant ascribes to suitable qualifications, experience, essential specialized skills, industry specialization and technological expertise (Carey *et al*., 2006). Indeed, majority of SME owner/managers have no professional, management or other formal qualifications (Stanworth and Gray, 1992). For example, many of SME managements lack financial skills or technical competence of how accounting information might be used to aid decision-making (Deakins, Logan and Steele, 2001; Collis and Jarvis, 2002; Marriott and Marriott, 2000; Breen, Sciulli and Calvert, 2003; Devi and Samujh, 2010). Critical competencies are necessary for competitive advantage, so SMEs should develop internally or access through the accounting firms in order to transfer best practices across firms (Gooderham *et al*., 2004). However, smaller firms often have difficulties to employ competent persons due to their incapability to offer competitive salaries and benefits (Jennings and Beaver, 1997).

Many of smaller firms lack resources (i.e., accounting knowledge and competence) to perform accounting functions internally (Everaert *et al*., 2006, 2007; Jayabalan *et al*., 2009). However, the employing of full-time employees (internal accountants) is not always a speedy process and there are obvious problems associated with terminating staff if they are no longer needed (Carey, 2008). While larger firms may be able to employ specialized full-time staff as the need arises, SMEs will not be able to employ specialised full-time staff due to resource constraints (Carey, 2008; Carey *et al*., 2006). One possible way for a smaller firm to obtain competencies is to utilise qualified persons (Gooderham *et al*., 2004). For instance, SMEs experience from the deficiency of managerial competence, which can be complemented by professional accountants that provide accounting activities to the SME managements when and where they need (Everaert *et al*., 2006, 2007; Jayabalan *et al*., 2009). For example, professional accountants 'services to the small firms can encapsulate a range of competencies providing an important source of competitive advantage (Gooderham *et al*., 2004). Therefore, by firms (Gooderham *et al*., 2004) relying on outsourcing, smaller firms can obtain the competence they need from small accounting.

Moreover, SMEs rely on professional accountants because they perceive that professional accountants are competent and proficient to provide a value-for money in the provision of accounting functions (Leung, Raar and Tangey, 2008). Thus, the presence of accounting outsourcing practices has provided the best option for SME survival (Jayabalan *et al*., 2009). This is more significant for Iranian SMEs (Naderian, 2010). In fact, the involvement of a professional accountant is seen as a positive indication and contribution min addressing asymmetric information issues (Naderian, 2010; Marlow and Carter, 2005).

2.6 Resource Availability and Decision to Outsource

Resources are one of the major factors involved in outsourcing services from third parties (Ya Ni and Bretschneider, 2007). This is because some contractors have better infrastructure and expertise in the field than SMEs. Therefore, outsourcing becomes a better option than incurring a large investment. In addition, a company may be able to free up resources for other purposes by outsourcing certain functions or departments to third parties. In other words, outsourcing allows a company to redirect its resources. The human resources can be redirected to other activities, allowing people to play a more valuable role based on their competencies (McIvor, 2009).

Recent literature presents empirical evidence regarding the outsourcing of e-government services and stresses that resources are one of the major factors involved in contracting out government services (Ya Ni and Bretschneider, 2007; Domberger and Fernandez, 1999). This is because some contractors have better infrastructure and expertise in the field than the government. Therefore, outsourcing becomes a better option than incurring a large investment. In addition, a company may be able to free up resources for other purposes by outsourcing certain functions or departments to third parties. In other words, outsourcing allows a company to redirect its resources. The human resources can be redirected to other activities, allowing people to play a more valuable role based on their competencies (McIvor, 2009).

Smaller firms can access complementary resources (e.g., human capital or competence) from external sources when they can gain no human capital to perform their activities internally (McIvor, 2009). Hence, the TCE discusses a view that if firms are to grow they should be open and have adaptive systems where knowledge is gained from outside the firm (Worrall, 2007). Therefore, the TCE argues SME owner/ managers should

learn to exploit the resources available outside the firm in competitive environment (Worrall, 2007; Gooderham *et al*., 2004).

A key prerequisite for the SME clients is an understanding of how to manage resources that the firm does not own (Everaert *et al*., 2006; Gottschalk and Solli-Sæther, 2006). From a service provider's perspective, there are many potential opportunities and benefits for the SME clients to utilize professional accountants while they are confronted with limited resources in a competitive business environment (Blackburn *et al*., 2010; Gottschalk and Solli-Sæther, 2006). These opportunities and benefits can be derived from outsourcing of accounting functions to a professional accountant especially, those requiring technical competence and expertise or skill (Doving and Gooderham, 2008; Carey *et al*., 2006; Gottschalk and Solli-Sæther, 2006). Additionally, internal provision of accounting practices requires SMEs to invest in accounting expertise and in training and development to keep this expertise up-to-date (Speklé *et al*., 2007).

2.7 Asset Specificity and Decision to Outsource

Two general types of specific assets include physical assets (e.g. specific equipment and machinery) and human assets (i.e. human capital) describing transaction-specific knowledge and skills (Lamminmaki, 2005; Ellram *et al*., 2008; McIvor, 2009). Rieple and Helm (2008) argue that "asset-specificity refers to the degree to which an asset is valuable in the context of a specific transaction; this is relevant because of its interplay with opportunism". Asset specificity refers to specialized knowledge, language, skills and expertise concerning the specific characteristics of the enterprise, related to accounting functions (Everaert *et al*. 2010).

According to TCE theory, asset specificity is one of the critical factors affecting outsourcing intensity of accounting functions (Reeves *et al.*, 2010; Everaert *et al.*, 2006, 2010; Williamson, 1999). There are two general types of specific assets, namely physical (tangible) assets (i.e. specific equipment and machinery) and (intangible) human assets (e.g. human capital) (Williamson, 1985; Greenberg *et al.*, 2008; McIvor 2009). Indeed, asset specificity (physical and human assets) describes the nature of the transaction (Nicholson *et al.*, 2006; Reeves *et al.*, 2010). Asset specificity refers to the degree of idiosyncrasy (customization), of the assets necessitated by buyers (firms) and suppliers (external service providers) to complete the transaction (Nicholson *et al.*, 2006; Reeves *et al.*, 2010). Highly asset-specific investments signify costs that do not have value outside the transaction (i.e., insourcing is more appropriate) (McIvor, 2009). The costs can be in the form of physical asset specificity (e.g., level of product customization) and human asset specificity (i.e., level of specialized knowledge involved in the transaction) (Reeves *et al.*, 2010; McIvor, 2009). Asset specificity can be specific or idiosyncratic (e.g., highly customized to the firm) and non-specific (i.e., highly standardized) or mixed (i.e., both standardized and customized elements in the transaction) (McIvor, 2009)

In fact, human assets are specific when professional accountants require specialized knowledge of the specific characteristics of the firm so as to carry out a specific accounting function (Everaert *et al.*, 2010). According to TCE, when asset specificity is low, and transactions are relatively frequent, transactions might be governed by outsourcing (Watjatrakul, 2005; Jiang *et al.*, 2007; Chang *et al.*, 2009). In other words, higher levels of asset specificity would lead to a lower amount of the core businesses being outsourced (Chang *et al.* Jiang *et al.*, 2007). However, human asset specificity is an important driver for the outsourcing in internal audit function (Spekle´ *et al.*, 2007),

and accounting services (Everaert *et al.*, 2010). Therefore, Everaert *et al.* (2010) found that outsourcing of accounting tasks is significantly associated with asset specificity. Overall, the TCE perspectives argue that asset specificity is a critical factor influence outsourcing decisions (Watjatrakul, 2005; Everaert *et al.*, 2010).

Generally, assets are specific if their value is to a large extent higher in the particular exchange relationship than in their next best, alternative use (Nicholson *et al.*, 2006). The level of specificity determines the form of governance (sourcing decisions) (Nicholson *et al.*, 2006; Reeves *et al.*, 2010). In other words, the degree of asset specificity of accounting functions depends on the nature of the accounting functions (Speklé *et al.*, 2007). For example, non-specific transactions, such as accounts payables do not need dedicated assets for particular firms, and therefore can be processed using standard equipment and non- specialized knowledge (Nicholson *et al.*, 2006). Conversely, idiosyncratic transactions such as management accounting (product costing) and financial planning or financial management services involve specialized knowledge of accounting processes and the associated environment (Nicholson *et al.*, 2006). Consequently, the degree of asset specificity depends on the role that the accounting functions play in managing the firm (Speklé *et al.*, 2007). In fact, outsourcing is efficient at low levels of asset specificity (e.g., low transaction cost), while high levels favour provision within the firm and insourcing is managed (e.g., hierarchical governance of the transaction) (Nicholson *et al.*, 2006).

In the accounting context, physical assets refer to the accounting software used in the firm and human asset refer to information and knowledge which may be acquired from the market (Dibbern and Heinzl, 2009; Everaert *et al.*, 2010). For instance, physical and human assets are specific when accountants require specialized knowledge of the

certain characteristics of the enterprise so as to process a specific accounting practice (Everaert *et al*., 2010). However, accounting functions is inclined to be more people-intensive and less capital-intensive (Brouthers and Brouthers 2003; Everaert *et al*., 2010). For example, accounting functions are mainly people-intensive and asset specificity focuses primarily on human asset specificity (Everaert *et al*., 2010). Overall, asset specificity has a major factor impact on sourcing decisions (Watjatrakul, 2005). For example, according to TCE, when asset specificity (i.e., physical asset and human capital) is low, and transactions are relatively frequent, outsourcing will be used (Jiang *et al*., 2007; Chang *et al*., 2009). In other words, high asset specificity leads to transactional difficulties, and insourcing is utilized (Jiang *et al*., 2007). For example, the TCE posits that when the accounting functions involve high levels of asset specificity, the search for external accountants might be longer and the contractual negotiations more debatable (Espino-Rodríguez *et al*., 2008; Thouin *et al*., 2009).

 Faced with those conditions, it is suggested that insourcing provides a means of preventing high transaction costs and allows more frequent adaptations (Espino-Rodríguez *et al*., 2008; Thouin *et al*., 2009). On the other hand, low-accounting functions may be governed with an outsourcing design (Espino-Rodríguez *et al*., 2008). When accounting practices become more customized to a firm and more specialized, asset specificity intensifies and, therefore, transferring these functions to an accounting firm may be prolonged, complex , incomplete and costly (Everaert *et al*., 2010). Conversely, when asset specificity decreases, transferring accounting functions to external accountant is more appropriate (Everaert *et al*., 2010). Taken as a whole, TCE perspective argues that in the presence of high asset specificity, accounting practices have a tendency to be internalized as a consequence of the opportunistic behavior that may otherwise result (Lamminmaki, 2007).

2.8 Conceptual Framework
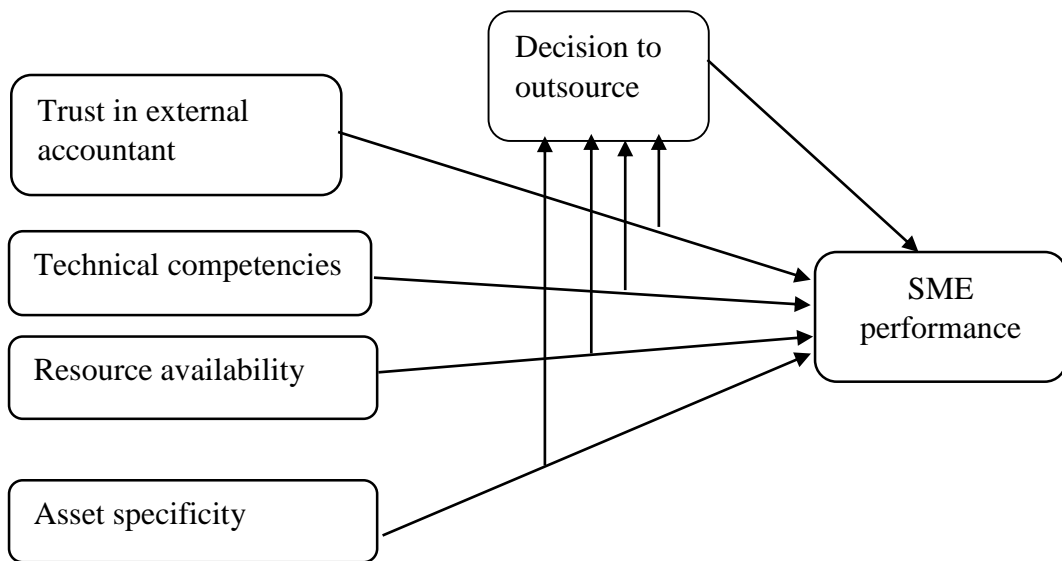
Figure 2.1: Conceptual Framework

Source; author 2017

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter covers the research design, target population, sampling procedure and sample size, data collection method, data validity and reliability, data analysis and presentation, ethical consideration and finally the expected output.

3.1 Research Design

Research design is described as a blue print or outline for conducting a study in such a way that maximum control will be exercised over factors that could interfere with the validity of the research results (Polit & Hungler, 1999). This study adopted both descriptive and explanatory research design. Descriptive research describes the characteristics of a population or phenomenon. Involves gathering data that describes events and then organizes, tabulates, depicts and describes the data collection (Gass and Hopkins 1984). It is very important in reducing the data to a manageable form. Explanatory research design focuses on explaining the phenomenon of this study in a detailed manner to provide more information about the subject matter. The basic idea behind explanatory research is to measure variables using data collected from a representative sample and then to examine relationships among the variables. In most instances, explanatory research attempt to capture attitude or patterns of past behavior (cause effect relationship) (Hagan, 2000). This design is best for investigating determinants of outsourcing of accounting functions and is effect on performance of SMEs.

3.2 Target Population

The population of study comprised registered SMEs owners/managers in Uasin Gishu County. According to Uasin Gishu County records there are 2053 in Eldoret Town registered SMEs, (Company Registrar, 2013). The study target SMEs within seven sectors, namely; financial services, Retail, Telecommunication, Agriculture, Hospitality, Professional services and Workshop services.

Table 3.1: Target Population

Name of SME	Target population
Financial services	450
Retail	470
Telecommunication	389
Agriculture	195
Hospitality	151
Professional services	147
Workshop services	251
Total	**2053**

Source (Company Registrar, 2013)

3.3 Sample Size and Sampling Design

A sample size is part of the target/accessible population that has been procedurally selected to represent it. Kothari (2009) defines a sample size as the number of items to be selected from the universe (population) to constitute a sample. From the target population of 2053 SMEs, Taro Yamane (1973) sample size formula was used to select a sample size of 335 SMEs as shown below;

$$n = \frac{N}{1 + N_{e^2}} = \frac{2053}{1 + 2053_{0.05^2}}$$

$$= 335$$

Where:

n = Sample size

N = Population size

e = the error of Sampling

This study allowed the error of sampling on 0.05. Thus, sample size was 335 SMEs.

3.3.1 Sampling Procedure

Sampling procedure is defined as a process of selecting a suitable sample for the purpose of determining the parameters   or a description of the strategies, which the researcher will use to select representative respondents from the accessible/target population (Adams *et al*., 2007). The study used cluster sampling technique to select the SMEs where owners/managers were picked. Therefore, SMEs were divided into seven clusters (sectors) where the sample size was distributed according to Neyman (1934) allocation formula. The purpose of the method is to maximize survey precision, given a fixed sample size. With Neyman (1934) allocation, the best sample size for stratum h would be:

$$n_{h=} \left(\frac{N_h}{N}\right) n$$

Where,

nh - The sample size for stratum h,

n - Total sample size,

Nh -The population size for stratum h,

N - The total population

Hence, distributions were as follows;

Table 3.2: Sampling

Name of SME	Target population	$n_{h=}\left(N_h/N\right)n$
Financial services	450	73
Retail	470	77
Telecommunication	389	63
Agriculture	195	32
Hospitality	151	25
Professional services	147	24
Workshop services	251	41
Total	**2053**	**335**

The researcher assigned random numbers to respondents in each street then calculate the max-value of the sampling interval (the number of individuals in the population divided by the number of individuals to be chosen for the sample, Select a random number between 1 and the max-value, and repeatedly add the max value to select the rest of the SMEs. And Choose the sample by selecting the SMEs corresponding to the number sequence obtained.

3.4 Data Collection Instrument and Procedures

3.4.1 Questionnaires

Instruments refer to the tools to be used for collecting data and how the tools will be developed, Oso and Onen (2005). The research utilized both primary and secondary data. The secondary data was obtained from previous reports as well as the internet. The primary data on the other hand is to be obtained from questionnaires. Questionnaires are to be used to obtain the primary data required for the project, which are to be self-administered by the researcher in the field. Questionnaires are best suited for surveys (Saunder *et al.*, 2007). This research employed a Likert scale i.e. strongly disagrees, strongly agree, in rating the various responses. The respondents are required to read, understand and tick an appropriate choice. The respondents comprised of the SME manager/owners in Uasin Gishu.

The questionnaires are to be administered by the researcher so as to obtain more information and also obtain clarity of information obtained from the respondents.

3.4.2 Validity and Reliability of the Instruments

Validity

According to O'leary (2009) validity is based on the assumption that what is being studied can be measured and captured. It is thus the extent to which a research instrument is able to measure what was intended to measure. Validity of the tools was cross checked with the help of the supervisor and classmates to ensure that the questions answer the variables to be measured.

Reliability

According to Panton (2000) reliability is the quality attributed to proposition or measures of the degree to which they conform to establish the truth.

For this study, reliability is to be achieved through a pilot test. The research employed the use of questionnaires. The purpose of construct reliability is to show that the items measured are correlated with what they purport to measure and that the items do not correlate with other constructs. Cronbach's alpha was used to determine reliability, where Cronbach's coefficient, having a value of more than 0.6 is considered adequate for such explanatory work (Heir *et al*, 2006).

3.5 Data Analysis and Presentation.

Data was analyzed both quantitatively and qualitatively. Data analysis was facilitated by use of SPSS (Statistical Package for Social Science) Computer package. Qualitative data was analyzed using thematic analysis. Descriptive methods were employed in analyzing qualitative data where frequencies and proportions were used in interpreting the respondent's perception of issues that were raised in the questionnaires so as to answer the research questions. Descriptive statistics such as frequency distribution, percentages, means and standard deviations were calculated and data presented in form of tables, graphs and charts were used. Inferential statistics were used to draw implications from the data with regard to the regression model. Baron and Kenny (1986) steps for mediation was applied in testing for mediation and the Multiple regression model which was used in this study was as follows;

Model 1............ $Y = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \varepsilon_i$

Model 2............$M = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \varepsilon_i$

Model 3…………$Y = \alpha + \beta_1 M + \varepsilon_i$

Model 4…………..$Y = \alpha + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \beta_5 M + \varepsilon_i$

Y= firm performance

α = constant.

β_1… β_5= the slope which represents the degree in which SME performance changes as the independent variable change by one unit variables.

x_1= Trust in external accountant

x_2= Technical competencies

x_3= Resource availability

x_4= Asset Specificity

M= Mediator, decision to outsource

ε = error term

In testing mediation effect of decision to outsource, the Sobel Macro was used which estimates the size of an indirect effect of a variable X on Y through a single mediator M, and computes both normal theory (Sobel's test) and bootstrap approaches for inference.

In order to test for multicollinearity among the predictor variables, variance inflation factor (VIF) and tolerance were applied. The tolerance indicator for predictor variables greater than 0.1 and VIF values less than 10 indicates that there is no multicollinearity

problem (Neter *et al* -1996), (Ott and Longnecker 2001). Variables were tested at a significant level of 0.01 (1%) and data presentation was done using tables.

3.6 Assumptions of Regression Model

First, linear regression needs the relationship between the independent and dependent variables to be linear. It is also important to check for outliers since linear regression is sensitive to outlier effects. The linearity assumption can best be tested with scatter plots.

Secondly, the linear regression analysis requires all variables to be multivariate normal. Normality can be checked with a goodness of fit test, e.g., the Kolmogorov-Smirnov test.

Thirdly, linear regression assumes that there is little or no multicollinearity in the data. Multicollinearity occurs when the independent variables are too highly correlated with each other. Multicollinearity may be tested with three central criteria:

1) Correlation matrix – when computing the matrix of Pearson's Bivariate Correlation among all independent variables the correlation coefficients need to be smaller than 1.

2) Tolerance – the tolerance measures the influence of one independent variable on all other independent variables; the tolerance is calculated with an initial linear regression analysis. Tolerance is defined as $T = 1 - R^2$ for these first step regression analysis. With T values greater than 0.1 indicate that there is no multicollinearity.

3) Variance Inflation Factor (VIF) – the variance inflation factor of the linear regression is defined as $VIF = 1/T$. With VIF values less than 10 indicate that there is no multicollinearity.

The fifth assumption of linear regression analysis requires that there is little or no autocorrelation in the data. Autocorrelation occurs when the residuals are not independent from each other. In other words when the value of y(x+1) is not independent from the value of y(x).

Durbin-Watson's d tests the null hypothesis that the residuals are not linearly auto-correlated. While d can assume values between 0 and 4, values around 2 indicate no autocorrelation. As a rule of thumb values of $1.5 < d < 2.5$ show that there is no auto-correlation in the data.

The last assumption of the linear regression analysis is homoscedasticity. The scatter plot is good way to check whether the data are homoscedastic (meaning the residuals are equal across the regression line). The Goldfeld-Quandt Test can also be used to test for heteroscedasticity.

3.7 Ethical Consideration

The study was undertaken bearing in mind all the ethical concerns and attempted to uphold them. Permission to carry out the research was sought from the relevant authorities and from the participants whom were involved in the study. During the course of the study, the respondents were assured of confidentiality, anonymity, and researcher's responsibility. The study maintained confidentiality of all data collected to the extent that it was agreed upon with the respondents.

CHAPTER FOUR

RESULTS AND DISCUSIONS

4.0 Introduction

This chapter presents the findings and discussions of the data that was collected from the field based on specific objectives of the study presented in chapter one. This was done through the use of frequencies, graphs, correlation analysis and multiple regression analysis. Results have been presented in such a way that they answer the research questions.

4.1 Response Rate

Out of three hundred and thirty five (335) Small and Medium Size Enterprises (SMEs) sampled and questionnaires administered, three hundred and four (304) responded. This gives a responds rate of 90.7% percent. This responses rate was adequate for analysis and reporting. This ensured a small margin of error and good precision (Anderson and Williams, 2003).

4.2 Descriptive Statistics

The study sought to establish the gender of the respondents as part of the demographic characteristics in the study. The background information of the respondents in the study facilitates in the determination of how this factors determine the direction of the investigation regarding the phenomenon. Thus, the age distribution, gender, level of education were examined as the respondents' demographic information while business type, monthly income from the business, position of the respondent in the business and the number of years that the business has been in existence were sought as business background information. The findings regarding this were summarized and presented in Table 4.1.

Table 4.1: Descriptive statistics

		Frequency	%
Age	Below 25 years	75	24.7
	26-30 years	97	31.9
	31-35 years	85	28
	41-45 years	26	8.6
	46-50 years	1	0.3
	Above 50 years	20	6.6
	Total	304	100
Gender	Male	203	66.8
	Female	101	33.2
	Total	304	100
Highest level of education	Primary	22	7.2
	Secondary	48	15.8
	Vocational	137	45.1
	First degree	32	10.5
	Masters	40	13.2
	Others	25	8.2
	Total	304	100
Business type	Financial services	51	16.8
	Retail	46	15.1
	Telecommunication	58	19.1
	Agriculture	40	13.2
	Hospitality	47	15.5
	Workshop services	24	7.9
	Others	38	12.5
	Total	304	100
Business monthly income	Below KShs. 10,000	104	34.2
	KShs. 11,000 - 50,000	62	20.4
	KShs. 51,000 - 90,000	111	36.5
	Above KShs. 100,000	27	8.9
	Total	304	100
Position in business	Owner	105	34.5
	Manager	46	15.1
	Employee	153	50.3
	Total	304	100
Business existence	Less than 1 yr	55	18.1
	1-2 yrs	46	15.1
	2.1-3 yrs	20	6.6
	3.1-5 yrs	37	12.2
	5.1-10 yrs	47	15.5
	Over 10 yrs	99	32.6
	Total	304	100

Regarding the age of the registered SMEs owners/managers, the findings in Table 4.1 revealed that 97 (31.9%) were aged below 25 years, 75 (24.7%) are aged between 26 to 30 years while 85 (28%) are aged between 31 to 35 years, indicating that over 83% of the SME owners/ managers were aged 35 years and below. The findings also showed that less than 16% of the SME owners/managers are aged above 40 years indicating a clear domination of the SME sector by younger individuals.

The findings in Table 4.1 also showed that 203 (66.8%) of the SME owners/ managers are male while 101 (33.2%) are female. Although there is clear domination of males in the SME sector in Uasin Gishu County, it also highlights that females experience difficulties in accessing the same kind of resources and opportunities for them to be successful in the SME sector and eventually attract more females in this sector of the economy.

The findings in Table 4.1 also showed that 137 (45.1%) of the SME owners/ managers have attained vocational level of education, 48 (15.8%) have attained secondary level of education, 40 (13.2%) have attained masters level of education, 32 (10.5%) have attained their first degree, 25 (8.2%) have other education levels while 22 (7.2%) have attained primary level of education as their highest level of education. This clearly showed that majority of the SME owners/ managers were qualified in terms of their education hence high credibility of the information obtained from them regarding their SMEs.

The findings in Table 4.1 concerning the background characteristics of the SMEs showed that 58 (19.1%) of the SMEs were telecommunication businesses which comprises those trading in telecommunication merchandise such as mobile phones and their accessories, 47 (15.5%) were hospitality types such as restaurants, cafes, eateries

and hotels, 46 (15.1%) were retail such as general merchandise shops and kiosks, 51 (16.8%) offer financial services, 40 (13.2%) are agricultural based SMEs, 38 (12.5%) are other types of SMEs within the sampling categories while 24 (7.9%) are workshops. There are different types of SMEs in Uasin Gishu County with telecommunication types and those who offer financial services dominating.

The findings also showed that 111 (36.5%) of the SMEs have a monthly income of KShs. 51,000 to KShs. 90,000, 104 (34.2%) have below KShs. 10,000 monthly, 62 (20.4%) have between KShs. 11,000 to KShs. 50,000 of monthly income while 27 (8.9%) have over KShs. 100,000 monthly. Kenya is currently categorized as a middle-income country and the SMEs in such category of countries contribute about 70% of GDP (Hidayet *et al.,* 2010). However, the great diversity in the SME sector means different levels of income hence a challenge to the sector profitability levels.

The findings also showed that 153 (50.3%) of the respondents were employees, 105 (34.5%) were owners of the SMEs while 46 (15.1%) were managers in the SMEs. This showed that there is adequate mix of the source of data from the various cadres in the SMEs and also showed that there was diverse and rich information on the phenomenon under investigation.

Finally, regarding the background information of the SMEs, the findings showed that 99 (32.6%) of the SMEs have been existing for over 10 years, 55 (18.1%) have existed for less than 1 year, 47 (15.5%) have existed for over 5 to 10 years, 46 (15.1%) have existed for 1 to 2 years, 37 (12.2%) have existed for over 3 to 5 years while 20 (6.6%) have existed for over 2 to 3 years. This means that there is diversity in terms of the market experience from SMEs that were started recently and those which have been operating for some years.

4.3 Reliability

Cronbach's alpha, α (or *coefficient alpha*), developed by Lee Cronbach in 1951, measures reliability, or internal consistency. "Reliability" is how well a test measures what it should. Cronbach's alpha tests to see if multiple-question Likert scale surveys are reliable. These questions measure latent variables — hidden or unobservable variables. The study thus sought to establish the reliability or internal consistency and the findings were summarized and presented in Table 4.2.

Table 4.2: Reliability

	Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
Decision to Outsource	0.646	0.660	7
Owners/managers Trust	0.728	0.721	4
Technical competence	0.760	0.768	6
Internal resource availability	0.718	0.726	5
Asset specification	0.744	0.740	5
Performance of SMEs	0.694	0.700	13

A rule of thumb for interpreting alpha for dichotomous questions (i.e. questions with two possible answers) or Likert scale questions is: $\alpha \geq 0.9$, excellent, $0.9 \geq \alpha \geq 0.8$, good, $0.8 \geq \alpha \geq 0.7$, acceptable, $0.7 \geq \alpha \geq 0.6$, questionable, $0.6 \geq \alpha \geq 0.5$, poor, $0.5 > \alpha$, unacceptable. The Cronbach's alpha values from Table 4.1 has a minimum of 0.646 and a maximum of 0.760, thereby rendering the level of internal consistency as questionable for decision to outsource and performance of SMEs and acceptable for owners/ managers trust, technical competence, internal resource availability and asset specification. The use of the rule of thumb above is taken with caution in this case because a high level for alpha may mean that the items in the test are highly correlated.

However, α is also sensitive to the number of items in a test where a large number of items means a larger α and vice versa. Thus, if α is high, it means there are redundant questions while a low value for alpha may mean there aren't enough questions on the test. Thus, in this case, the level of internal consistency is reliable.

4.4 Decision to Outsource

Outsourcing is a strategy through which the major non-core functions of an organization are transferred to specialists, efficient external providers. As a mediating factor in this study, the decision of the SMEs to outsource was investigated by seeking the perspective of the SME owners/ managers on various aspects of outsourcing and in particular, the specific gaps in the SME that called for outsourcing. The findings regarding this were summarized by use of means and standard deviations (derived from the responses on a 5-point Likert scale with 5 indicating strong agreement, 4 agree with the statement, 3 indicating neutrality 2 disagree and 1 indicating strong disagreement with the statement) and presented in Table 4.3.

Table 4.3: Decision to Outsource

N=304 My firm outsource external accountant to….	Mean	Std. Deviation	Skewness	Kurtosis
File VAT returns	2.51	1.44	0.364	-1.114
Prepare financial statements	2.94	1.30	-0.091	-1.248
Prepare payroll	2.72	1.58	0.464	-1.419
Audit work	3.24	1.45	-0.182	-1.204
Profit analysis	2.93	1.02	-0.030	-0.481
Financial advice	3.04	1.52	0.143	-1.594
File tax returns	2.88	1.46	0.443	-1.356
DECISION TO OUTSOURCE	**2.77**	**0.626**	**0.593**	**0.551**

Based on the findings in Table 4.3, the mean of 2.51 (std. dev = 1.44) indicated overall disagreement with the fact that the SMEs outsource external accountants to file VAT returns. On the other hand, a mean of 2.94 (std. dev = 1.30) indicated overall neutrality with the statement that they outsource external accountants to prepare financial statements. Furthermore, majority of the respondents were neutral with the statements that they outsource external accountants to: prepare payroll, mean = 2.72 (std. dev = 1.58), audit work, mean = 3.24 (std. dev = 1.45), carry out profit analysis, mean = 2.93 (std. dev = 1.02), offer financial advice, mean = 3.04 (std. dev = 1.52) and to file tax returns, mean = 2.88 (std. dev = 1.46). The overall mean response indicated overall neutrality, mean = 2.77 (std. dev = 0.626).

Skewness measures the degree and direction of asymmetry while kurtosis is a measure of tail extremity reflecting either the presence of outliers in a distribution or a distribution's propensity for producing outliers. The overall accepted rule of thumb for skewness and kurtosis is that if the value is between +/-1.96 limits suggests that the departure from normality is not too extreme. The findings in Table 4.2 regarding skewness and kurtosis showed all values were within the +/- 1.96 limits suggesting that though asymmetry might exist, it is not significant and that there is an insignificant measure of outliers to affect the data. This indicates normality.

The reason for outsourcing can vary, but most of the reasons focus on several basic considerations (Targett, 2000). Empirical studies revealed that most of SMEs outsource accounting activities to external accountants. The purpose of outsourcing is to improve competitive advantage. However, the finding of this study indicate that majority of the SMEs in Uasin Gishu County do not outsource accounting activities and this can be because of the size of the business in terms of their capacity to outsource.

4.5 Owner's or Manager's Trust

Trust in service providers is described as one party believing to the other party based on the economic indication that the other party would carry out the commitment and act in a predictable way. The study thus sought to establish the perspective of the owners/ managers on trust with regard to outsourcing. Findings were summarized and presented in Table 4.4.

Table 4.4: Owner's/Manager's Trust

	Mean	Std. Deviation	Skewness	Kurtosis
We have confidence that the external accountant will inform correctly	2.860	1.320	0.069	-1.161
I feel that external accountant care about what happens to us.	2.605	1.293	0.102	-1.284
The relationship between the owner-manager and the external accountant is based on trust	3.342	1.051	0.122	-1.071
I feel that the external accountant will perform his duties correctly	2.858	1.329	0.330	-1.180
OWNER'S/MANAGER'S TRUST	**2.959**	**0.736**	**0.429**	**0.003**

The findings in Table 4.4 revealed that majority of the owners/ managers were neutral with regard to having confidence that the external accountant will inform correctly, mean = 2.86 (std. dev = 1.30). Furthermore, majority of the respondents were also neutral with regard to their feeling that external accountant cares about what happens to them, mean = 2.605 (std. dev = 1.293). The findings however revealed an agreement with the statement that the relationship between the owner/ manager and the external accountant is based on trust, mean = 3.342 (std. dev = 1.015). The findings also showed neutrality with the statement that the external accountant will perform their duties correctly, mean = 2.858 (std. dev = 1.358). The overall response on the owner/ manager trust was neutral, mean = 2.959 (std. dev = 0.737). Normality tests indicated that

skewness and kurtosis values were within the rule of thumb of +/- 1.96. Gainey and Klaas (2005) indicate that trust is as an expectation that another party (supplier) does not act in an opportunistic manner. Threat of opportunism is indicative of a lack of trust that an outside service provider will honestly fulfill task or project obligations (Ghoshal and Moran, 1996). The greater this threat, the greater the degree to which a firm (client) has to employ complex and costly governance mechanisms to safeguard its interests in its transactions with an external service provider (Dyer, 1996) and this is the fear for many SMEs in developing countries. Everaert *et al.* (2010) indicate that the SME's decision to outsource accounting services is based on the characteristics of the transaction and the interpersonal trust of the owner/manager in the external accountant such that the higher the perceived trust in professional accountants, the higher is the likelihood that the owner/managers of SMEs will choose to outsource their management accounting functions and vice versa.

4.6 Technical competencies

Technical competence is the most valuable asset in an organization because owners use to improve organizational performance. The study thus sought the views of the respondents regarding the qualification of the external accountant, knowledge about the industry, special skills, necessary technological skills and specialization as well as management skills. The findings regarding this were summarized and presented in Table 4.5.

Table 4.5: Technical competencies

N=304	Mean	Std. Deviation	Skewness	Kurtosis
The external accountant has appropriate qualification	3.020	1.721	-.066	-1.768
The external accountant has knowledge about the industry	2.813	1.330	.103	-1.100
The accountant has necessary special skills	2.878	1.311	.271	-1.027
The accountant has necessary technological expertise	3.099	1.443	.092	-1.437
The accountant has specialization in the industry	2.813	1.060	.063	-1.248
The accountant has management skills	2.638	1.377	.023	-1.452
TECHNICAL COMPETENCIES	**2.877**	**0.936**	**0.142**	**-0.654**

The findings in Table 4.5 show that majority of the respondents had a neutral perspective with the statement that the external accountant has appropriate qualification, mean = 3.020 (std. dev = 1.721) indicating skepticism on the qualification of the outsourced personnel. The respondents also had a neutral response to the statement that the external accountant has knowledge about the industry, mean = 2.813 (std. dev = 1.330). In addition, there was also overall neutrality with the statement that the accountant has necessary special skills, mean = 2.878 (std. dev = 1.311). The respondents also showed neutrality with the statements that: the accountant has necessary technological expertise, the accountant has specialization in the industry and the accountant has management skills with means, 3.099 (std. dev = 1.443), 2.813 (std. dev = 1.060) and 2.638 (std. dev = 1.377) respectively. The overall mean response was 2.877 (std. dev = 0.936) indicating overall neutrality with regard to technical competencies attached to the outsourced personnel. The skewness and kurtosis were found to be within the limits hence the normality assumption holds. Attributes of

technical competence to an accountant include appropriate qualifications and experience, essential specialized skills, industry specialization and technological expertise (Carey *et al*., 2006).Technical competence is the most valuable asset in an organization because owners use to improve organizational performance. Therefore, by relying on outsourcing, smaller firms can obtain the competence they need from external service providers (Gilley *et al.,* 2004). Moreover, the reliance by SMEs on external accountants is indicated to be a result of the perceptions of SMEs that external accountants are competent and able to provide a value-for money service in providing accounting services (Leung *et al.,* 2008). However, the findings have indicated some level of reservation and lack of trust in the competence levels of the outsourced or external accountant. This influences their decision to either outsource or not basing on risk perception.

4.7 Resource Availability

Resources are one of the major factors involved in outsourcing services from third parties. The resources at the disposal of the SMEs thus determine whether they would decide to outsource or not basing on the gaps in terms of resources. The study thus sought to investigate the issue of resource availability among the SMEs based on the perspectives of the respondents and hence determine their likelihood level of outsourcing or not. The findings regarding this were summarized and presented in Table 4.6.

Table 4.6: Resource Availability

N=304	Mean	Std. Deviation	Skewness	Kurtosis
The firm have enough staff to meet our obligation	2.984	1.551	.022	-1.607
The firm have qualified staff	2.997	1.236	-.247	-1.050
The audit firm have enough time to perform our duties on time	2.773	1.258	.466	-.787
The firm have enough infrastructure	2.928	1.350	-.143	-1.302
The firm's infrastructure meets the current business environment	2.707	1.326	.303	-1.080
RESOURCE AVAILABILITY	**2.877**	**0.763**	**-0.343**	**0.540**

The findings in Table 4.6 regarding resource availability shows that majority of the respondents were neutral with the statement that the firm have enough staff to meet their obligations, mean = 2.984 (std. dev = 1.551). The respondents also showed neutrality with the statement that the firm have qualified staff, mean = 2.997 (std. dev = 1.236). In addition, the respondents also showed neutrality with the statements that: the audit firm has enough time to perform their duties on time, mean = 2.773 (std. dev = 1.258), the firm has enough infrastructures, mean = 2.928 (std. dev = 1.326) and that the firm has a capacity in terms of capital, mean = 2.707 (std. dev = 1.326). The overall mean was 2.878 (std. dev = 0.763) indicating overall neutrality with the statements regarding resource availability in the audit firm. Assessment of skewness and kurtosis for normality showed that they were within agreeable limits hence no violation of the normality assumption. These findings are reflective of the inability of the SMEs to outsource based on various factors. Resources are one of the major factors involved in outsourcing services from third parties (Ya Ni and Bretschneider, 2007). This is because some contractors have better infrastructure and expertise in the field than SMEs. Therefore, outsourcing becomes a better option than incurring a large

investment. So, it is of great concern when the SMEs perceive the outsourcing firms as not having adequate resources to meet their demands.

4.8 Asset Specification

In terms of asset specification, there are generally two types of specific assets, physical and human where in this case, asset specification is the level to which a given asset has value within the context of a given transaction or activity. Thus, it is a critical component to any firm that offers outsourcing services. Thus, the study sought to investigation issues related to asset specification by seeking the perspectives of the respondents. The findings regarding this were summarized and presented in Table 4.7.

Table 4.7: Asset Specification

N=304	Mean	Std. Deviation	Skewness	Kurtosis
To obtain the accounting functions the accountant needs to acquire company specific information	2.852	1.569	.087	-1.508
The accounting software is custom-tailored to our firm	3.046	1.354	.205	-1.234
To perform the advisory services the accountant needs to obtain company-specific information	3.415	1.354	.130	-1.724
The way we perform the accounting functions is unique to our firm	3.158	1.410	-.069	-1.452
It would be costly in terms of time and resources to switch to an external accountant at the end of the financial year	3.322	1.635	-.169	-1.660
ASSET SPECIFICATION	**3.159**	**0.645**	**1.089**	**1.502**

The findings in Table 4.7 showed neutrality by the respondents with the statement that to obtain the accounting functions, the accountant needs to acquire company specific

information, mean = 2.852 (std. dev = 1.569). There was also neutrality with the statement that the accounting software is custom-tailored to their firm, mean = 3.046 (std. dev = 1.354). However, the findings showed overall agreement with the statement that to perform the advisory services, the accountant needs to obtain company-specific information, mean = 3.415 (std. dev = 1.410). The findings also showed neutrality with the statement that the way they perform the accounting functions in unique to their firm, mean = 3.322 (std. dev = 1.635). The findings also showed neutrality with the statement that it would be costly in terms of time and resources to switch to an external accountant at the end of the financial year, mean = 3.342 (std. dev = 1.633). The overall mean response regarding asset specification was 3.159 (std. dev = 0.645) indicating overall neutrality with the statements regarding asset specification. Assessment of the skewness and kurtosis showed that they were within the accepted limit of +/- 1.96 hence the data was assumed not to violate normality assumptions. Highly asset-specific investments signify costs that do not have value outside the transaction (i.e., in-sourcing is more appropriate) (McIvor, 2009). Everaert *et al*. (2010) found that outsourcing of accounting tasks is significantly associated with asset specificity. Generally, assets are specific if their value is to a large extent higher in the particular exchange relationship than in their next best, alternative use (Nicholson *et al.,* 2006). The level of specificity determines the form of governance (sourcing decisions).

4.9 SME Performance

Firm performance refers to the firm's success in the market, which may have different outcomes and is a focal phenomenon in business studies. The concept of firm performance implies measuring the results of a firm's policies and operations in monetary terms. In this study, this concept of firm performance was measured on the background of the independent factors as well as the decision to outsource and

specifically focused on the growth in sales, competition, number of employees, market size, customer satisfaction, efficiency, reputation as well as the development of new products and services. The findings regarding this were summarized and presented in Table 4.8.

Table 4.8: SME Performance

N=304	Mean	Std. Deviation	Skewness	Kurtosis
Growth in sales as expected	2.625	1.165	0.703	-0.546
Growth in sales in relation to competitors	2.947	1.265	0.031	-1.058
Growth in profit as expected	2.911	1.351	0.162	-1.188
Growth in profit in relation to competitors	2.750	1.204	0.137	-1.118
Employees has increased	3.352	1.644	-0.424	-1.445
Increased market size in new market	2.589	1.194	0.884	-0.500
Growth in capital for business operations	3.444	1.064	-0.382	-1.193
We have improved our efficiency	2.618	1.108	0.813	-0.283
We have created positive reputation	2.938	1.131	-0.317	-1.137
Customers satisfaction	3.207	1.140	0.527	-1.091
High customer loyalty	3.029	1.187	0.145	-1.204
High level of new customers	3.184	1.399	-0.048	-1.392
Ability to develop new products	3.375	1.504	-0.206	-1.440
FIRM PERFORMANCE	**2.99**	**0.584**	**0.000**	**1.577**

The findings in Table 4.8 showed that there is neutrality in terms of growth in sales as expected, growth in sales in relation to competitors, growth in profit as expected, growth in profit in relation to competitors and increase in employees, mean = 2.625 (std. dev = 1.165), mean = 2.947 (std. dev = 1.265), mean = 2.911 (std. dev = 1.351), mean = 2.750 (std. dev = 1.204) and mean = 3.352 (std. dev = 1.644) respectively. The findings also showed overall neutrality with the statements that there is increased

market size in new market, there is growth in capital for business operations, the is improved efficiency in the SMEs and there is positive reputation created, mean = 2.589 (std. dev = 1.194), mean = 3.444 (std. dev = 1.064), mean = 2.618 (std. dev = 1.108) and mean = 2.938 (std. dev = 1.131) respectively. The findings also showed overall neutrality by the respondents with regard to customer satisfaction, high customer loyalty, high level of new customers and the ability to develop new products, mean = 3.207 (std. dev = 1.140), mean = 3.029 (std. dev = 1.187), mean = 3.184 (std. dev = 1.399) and mean = 3.375 (std. dev = 1.504) respectively which indicated overall neutrality given the mean but a certain level of agreement with the statements as indicated by the standard deviation. The overall mean response for firm performance was 2.998 (std. dev = 0.584) indicating overall neutrality. The assessment of skewness and kurtosis showed that they were all within the +/-1.96 limit thus there is no violation of the normality assumption. Given the level of agreement, enhanced firm performance is a way to satisfy investors and is always shown by profitability, growth and market value (Cho & Pucik, 2005). Growth shows a firm's past ability to increase its size. Increasing size, even at the same profitability level, will raise its entire profit and cash generation. Bigger size also can bring economies of scale and market power, leading to greater impending profitability. Market value signifies the external valuation and belief of firms' future performance. It ought have a relationship with historical productivity and progression levels, but also incorporate future expectations of market changes and competitive moves.

4.10 Factor Analysis

Factor analysis is a method of data reduction. It does this by seeking underlying unobservable (latent) variables that are reflected in the observed variables (manifest variables). Factor analysis is a technique that requires a large sample size. Factor

analysis is based on the correlation matrix of the variables involved, and correlations usually need a large sample size before they stabilize.

KMO and Bartlett's Test findings were summarized in Table 4.9. The Kaiser-Meyer-Olkin measure of sampling adequacy varies between 0 and 1, and values closer to 1 are better. A value of approximately 0.6 is a suggested minimum where in this case, a value of 0.577 shows sampling adequacy. The Bartlett's test of sphericity tests the null hypothesis that the correlation matrix is an identity matrix. An identity matrix is matrix in which all of the diagonal elements are 1 and all off diagonal elements are 0. The aim is to reject this null hypothesis. According to the findings in Table 4.8, a chi-square (351) value of 12785.37 and a p-value of 0.000 indicated that the correlation matrix is not an identity matrix.

Table 4.9: KMO and Bartlett's Tests

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.	.649
Bartlett's Test of Sphericity	6461.213
	351
	0.000

The initial number of factors is the same as the number of variables used in the factor analysis. However, not all factors were retained. In this study, according to the findings in Table 4.10, only the first four factors were retained (as we requested).

Table 4.10: Total Variance Explained

Component	Initial Eigen values			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	7.002	25.933	25.933	5.512	20.413	20.413
2	5.496	20.355	46.288	5.317	19.692	40.105
3	3.287	12.174	58.462	4.384	16.237	56.342
4	2.955	10.944	69.405	3.527	13.064	69.405

Eigen values are the variances of the factors. Also, according to Table 4.10, because this study conducted the factor analysis on the correlation matrix, the variables are standardized, which means that the each variable has a variance of 1, and the total variance is equal to the number of variables used in the analysis.

This means that the cumulative % of variance explained by the first 4 components is 69.405%.

The idea of rotation is to reduce the number factors on which the variables under investigation have high loadings. Rotation does not actually change anything but makes the interpretation of the analysis easier. The idea of rotation is to reduce the number factors on which the variables under investigation have high loadings. The findings in Table 4.11 showed the factor loadings of the components based on the Kaiser Normalization Criterion. From the findings, the first seven components are loaded on the factor 1, the next 4 are loaded on factor 2, the next 6 are loaded on factor 3, and the next 5 are loaded on factor 4 while the last 5 are loaded on factor 5. Given that the components loaded substantially on the stated factors and can thus be used as factors in the analysis.

Table 4.11: Rotated Factor loadings

	1	2	3	4	5
File VAT returns	0.708				
Prepare financial statements	0.551				
Prepare payroll	0.744				
Audit work	0.844				
Profit analysis	0.525				
Financial advice	0.828				
File tax returns	0.895				
Inform correctly		0.685			
Care about us		0.649			
Relationship is based on trust		0.504			
Perform his duties correctly		0.754			
Appropriate qualification			0.840		
Knowledge about the industry			0.805		
Special skills			0.864		
Technological expertise			0.945		
Specialization in the industry			0.819		
Management skills			0.660		
Enough staff				0.616	
Qualified staff				0.800	
Enough time				0.815	
Infrastructure				0.676	
Business needs				0.898	
Company specific information					0.791
Software is custom-tailored					0.677
Require specific information advise					0.769
Our accounting functions is unique					0.828
Costly to switch to another external accountant					0.634

Extraction Method: Principal Component Analysis.
Rotation Method: Varimax with Kaiser Normalization.

4.11 Correlation Analysis

Correlation analysis is conducted to establish the level to which two factors converge or diverge together depending on the case so as to establish the significance of the relationship. A positive value of the correlation coefficient shows that the two variables move together in the same trend, and when there is a negative value, it shows that the variables move in opposite direction or trend. This means that correlation analysis depicts to a given degree, the aspect of how one factor influences another although

correlations do not imply a cause-effect relationship. The study thus carried out correlation analysis of the independent factors and the dependent factor and the findings were summarized and presented in Table 4.12.

Table 4.12: Correlation Analysis

	Firm performance	Managers trust	Technical competencies	Resource availability	Asset specification	Decision to outsource
Managers trust	0.608**	1				
Technical competencies	0.610**	0.511**	1			
Resource availability	0.656**	0.472**	0.533**	1		
Asset specification	0.593**	0.371**	0.409**	0.454**	1	
Decision to outsource	0.672**	0.478**	0.589**	0.592**	0.590**	1

** Correlation is significant at the 0.01 level (2-tailed).

From the findings in Table 4.12, managers trust has a positive and significant relationship with firm performance (r = 0.608) at 0.01 level of significance. This implies that there is a probability of 0.608 that the increase in managers' trust of the external firm will increase firm performance. This means that the responsibility of enhancing the trust of the owners or managers lies with the outsourced firm by making a deliberate assurance by improving their operations and services. The findings also showed that technical competencies has a positive and significant relationship with firm performance (r = 0.610) at 0.01 level of significance meaning that there is a 0.610 probability that firm performance will increase with increase in technical competencies of the outsourced firms. The findings also showed that resource availability has a positive and significant relationship with firm performance (r = 0.656) at 0.01 level of significance and means that there is a 0.656 probability that firm performance will

increase with increase in resource availability. The findings also revealed that there is a positive and in significant relationship between asset specification and firm performance (r = 0.593) at 0.01 level of significance indicating that there is a probability of 0.593 that firm performance will increase with increase in asset specification. The findings also showed that there is a positive and significant relationship between decision to outsource and firm performance (r = 0.672) at 0.01 level of significance indicating that there is a probability of 0.672 that firm performance will increase with increase in decision to outsource. The findings also revealed significant inter-factor relationships.

4.12 Regression Model

Regression is an analysis that assesses whether one or more predictor variables explain the dependent (criterion) variable. The regression has five key assumptions: Linear relationship, Multivariate normality, No or little multicollinearity, No auto-correlation and Homoscedasticity.

A regression model is generally used to assess and depict a cause-effect relationship that has been, to a certain degree, been depicted by the correlation analysis. The regression model gives the magnitude of the cause-effect relationship as well as the direction of the relationship. This is achieved through the estimation of the coefficients of estimations attributed to the explanatory variables.

Table 4.13 gives a summary of the predicted model related to the given independent variables.

Table 4.13: Model Summary

	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	Std. Error	Beta	T	Sig.	Tolerance	VIF
(Constant)	0.554	0.124		4.470	0.000		
Managers trust	0.192	0.050	0.220	3.805	0.000	0.403	2.484
Technical competencies	0.172	0.033	0.250	5.199	0.000	0.580	1.725
Resource availability	0.149	0.054	0.179	2.742	0.006	0.315	3.172
Asset specification	0.322	0.041	0.328	7.841	0.000	0.768	1.301
R		0.773					
R Square		0.598					
Adjusted R Square		0.593					
Std. Error of the Estimate		0.410					
F Change		111.31					
df1		4					
df2		299					
p-value		0.000					
a Dependent Variable: Firm performance							

According to Table 4.13, the R Square value indicates a relatively strong correlation between predictor variables and the response variable (firm performance). This is because the R value is positive (0.598). This means that the variation in firm performance is attributed by 59.8% change in the predictor variables.

The analysis of variance is important in assessing the significance of the variation contributed by the explanatory variables on the response variable compared to the variation contributed by the residuals. The study thus carried out the analysis of variance and the findings were summarized and presented in Table 4.13. The findings in Table 4.13 showed that the regression model accounts for more than 111 times the variation of the firm performance compared to the residuals, F-value (4) = 111.31, p-value = 0.000.

Multicollinearity can be assessed by examining tolerance and the Variance Inflation Factor (VIF) which are two collinearity diagnostic factors that can help identify multicollinearity. A small tolerance value indicates that the variable under consideration is almost a perfect linear combination of the independent variables already in the equation and that it should not be added to the regression equation. All variables involved in the linear relationship will have a small tolerance. It is suggested that a tolerance value less than 0.1 should be investigated further. If a low tolerance value is accompanied by large standard errors and non-significance, multicollinearity may be an issue. In this case, all tolerance levels indicated in Table 4.13 are significantly greater than 0.1.

The Variance Inflation Factor (VIF) measures the impact of collinearity among the variables in a regression model. The Variance Inflation Factor (VIF) is 1/Tolerance, it is always greater than or equal to 1. There is no formal VIF value for determining presence of multicollinearity. Values of VIF that exceed 10 are often regarded as indicating multicollinearity. From the findings in Table 4.13, all the VIF measures are greater than 1 and less than 10 indicating that multicollinearity is not a concern.

The findings in Table 4.13 showed that manager's trust has a positive and significant effect on firm performance ($\beta_1 = 0.220$, p-value = 0.000) and this can be explained further by assessing the value of the t-test which indicates that firm performance would be approximately 4 times higher given the change in manager's trust (t = 3.805). This implies that with each unit increase in manager's trust, firm performance will increase by 0.220 units. In addition, the findings revealed that technical competencies has a positive and significant effect on firm performance ($\beta_2 = 0.250$, p-value = 0.000) and this can further be evidenced by the value of the t-test which showed that firm performance would be approximately 5 times more given the change in technical

competencies (t = 5.199). This means that with each unit increase in technical competencies, there will be 0.250 units increase in firm performance. The study also showed that resource availability has a positive and significant effect on firm performance (β_3 = 0.179, p-value = 0.006) and this can further be evidenced by the value of the t-test which showed that firm performance would be approximately 3 time more given the change in resource availability (t = 2.742). This means that with each unit increase in resource availability, there will be 0.179 units increase in firm performance. Finally, the findings showed that asset specification has a positive and significant effect on firm performance (β_4 = 0.328, p-value = 0.000) and to a great extent this effect was important given the value of the t-test = 7.841. This means that with each unit increase in asset specification, there will be 0.328 unit increase in firm performance.

4.13 Mediating Using Bootstrapping

In testing mediation effect of decision to outsource, the Sobel Macro was used which estimates the size of an indirect effect of a variable X on Y through a single mediator M, and computes both normal theory (Sobel's test) and bootstrap approaches for inference. The output or findings were presented in Table 4.14. Note: DTU means decision to outsource, FP = firm performance and TIVC = Total independent variables combined.

Table 4.14: Mediation testing

Mediation **Effect of decision to outsource on the relationship between managers/owners Trust and firm performance**

Model = 4

   Y = Firm performance

   X = Managers trust

   M = Decision to outsource

Sample size 304

Outcome: Decision to outsource

Model Summary

R	R-sq	MSE	f	df1	df2	P
.4784	.2288	.4114	89.6160	1.0000	302.0000	.0000

Model

	coeff	Se	T	P	LLCI	ULCI
Constant	1.3738	.1525	9.0094	.0000	1.0738	1.6739
Management Trust	.4734	.0500	9.4666	.0000	.3750	.5718

Outcome: Firm performance

Model Summary

R	R-sq	MSE	f	df1	df2	P
.7467	.5576	.1842	189.6671	2.0000	301.0000	.0000

Model

	coeff	Se	t	P	LLCI	ULCI
Constant	.8413	.1149	7.3193	.0000	.6151	1.0695
Decision to outsource	.4358	.0385	11.3171	.0000	.3600	.5116
Managers Trust	.3241	.0381	8.5060	.0000	.2491	.3991

Direct effect of X on Y

Effect	SE	t	P	LLCI	ULCI
.3241	.0381	8.5060	.0000	.2491	.3991

Indirect effect of X on Y

	Effect	Boot SE	Boot LLCI	Boot ULCI
Decision to outsource	.2063	.0329	.1507	.2777

Mediation Effect of decision to outsource on the relationship between technical competence and firm performance

Model = 4

   Y = Firm performance

   X = Technical competence

   M = Decision to outsource

Sample size 304

Outcome: Decision to outsource

Model Summary

R	R-sq	MSE	f	df1	df2	P
.7889	.6224	.2014	497.7620	1.0000	302.0000	.0000

Model

	coeff	Se	t	P	LLCI	ULCI
Constant	1.0066	.0833	12.0804	.0000	.8426	1.1706
Technical competence	.6145	.0275	22.3106	.0000	.5603	.6687

Outcome: Firm performance
Model Summary

R	R-sq	MSE	f	df1	df2	P
.6843	.4683	.2214	132.5466	2.0000	301.0000	.0000

Model

	coeff	Se	t	P	LLCI	ULCI
Constant	1.3560	.1064	12.7452	.0000	1.1466	1.5653
Decision to outsource	.4460	.0603	7.3692	.0000	.3258	.5633
Technical competence	.1460	.0470	3.1080	.0021	.0536	.2385

Direct effect of X on Y

Effect	SE	t	P	LLCI	ULCI
.1460	.0470	3.1080	.0021	.0536	.2385

Indirect effect of X on Y

	Effect	Boot SE	Boot LLCI	Boot ULCI
Decision to outsource	.2732	.0494	.1768	.3689

Mediation **Effect of decision to outsource on the relationship between resource availability and firm performance**
Model = 4
   Y = Firm performance
   X = Resource availability
   M = Decision to outsource
Sample size 304
Outcome: Decision to outsource
Model Summary

R	R-sq	MSE	f	df1	df2	P
.5923	.3509	.3463	163.2307	1.0000	302.0000	.0000

Model

	coeff	Se	t	P	LLCI	ULCI
Constant	1.0976	.1355	8.0982	.0000	.8309	1.3644
Resource availability	.5571	.0436	12.7762	.0000	.4713	.6429

Outcome: Firm performance
Model Summary

R	R-sq	MSE	f	df1	df2	P
.7412	.5539	.1857	186.8564	2.0000	301.0000	.0000

Model

	coeff	Se	t	P	LLCI	ULCI
Constant	.9491	.1095	8.6662	.0000	.7336	1.1646
Decision to outsource	.3847	.0421	9.1282	.0000	.3018	.4676
Resource availability	.3299	.0396	8.3227	.0000	.2519	.4079

Direct effect of X on Y

Effect	SE	f	P	LLCI	ULCI
.3299	.0396	8.3227	.0000	.2519	.4079

Indirect effect of X on Y

	Effect	Boot SE	Boot LLCI	Boot ULCI
Decision to outsource	.2143	.0353	.1490	.2970

Mediation **Effect of decision to outsource on the relationship between asset specificity and firm performance**

Model = 4

   Y = FP

   X = **Asset Specificity**

   M = **Decision to outsource**

Sample size 304

Outcome: **Decision to outsource**

Model Summary

R	R-sq	MSE	F	df1	df2	P
.5902	.3484	.3476	161.4577	1.0000	302.0000	.0000

Model

	coeff	Se	t	P	LLCI	ULCI
Constant	.8446	.1556	5.4276	.0000	.5384	1.1509
Asset specificity	.6580	.0518	12.7066	.0000	.5561	.7599

Outcome: Firm performance

Model Summary

R	R-sq	MSE	f	df1	df2	P
.7145	.5106	.2038	156.9985	2.0000	301.0000	.0000

Model

	coeff	Se	t	P	LLCI	ULCI
Constant	.9313	.1248	7.4602	.0000	.6856	1.1769
Decision to outsource	.4354	.0441	9.8814	.0000	.3484	.5221
Asset specificity	.2967	.0491	6.0413	.0000	.2001	.3934

Direct effect of X on Y

Effect	SE	t	P	LLCI	ULCI
.2967	.0491	6.0413	.0000	.2001	.3934

Indirect effect of X on Y

	Effect	Boot SE	Boot LLCI	Boot ULCI
Decision to outsource	.2865	.0383	.2174	.3681

Total effect of independent variables on performance through decision to outsource

Model = 4

   Y = Firm performance

   X = Total effect of independent variables

   M = Decision to outsource

Sample size 304

Outcome: Decision to outsource

Model Summary

R	R-sq	MSE	F	df1	df2	P
.7730	.5975	.2145	448.2913	1.0000	302.0000	.0000

Model

	coeff	Se	t	P	LLCI	ULCI
constant	.1243	.1280	.9717	.3320	-.1275	.3762
Total effect of independent variables	.8999	.0425	21.1729	.0000	.8163	.9836

Outcome: Firm performance

Model Summary

R	R-sq	MSE	F	df1	df2	P
.7753	.6012	.1661	226.8397	2.0000	301.0000	.0000

Model

	coeff	Se	t	P	LLCI	ULCI
Constant	.6745	.1127	5.9843	.0000	.4527	.8964
Decision to outsource	.1764	.0506	3.4852	.0006	.0768	.2760
Total effect of independent variables	.6267	.0589	10.6373	.0000	.5108	.7427

Total effect of X on Y

Effect	SE	t	P	LLCI	ULCI
.7855	.0381	20.6353	.0000	.7106	.8604

Direct effect of X on Y

Effect	SE	t	P	LLCI	ULCI
.6267	.0589	10.6373	.0000	.5108	.7427

Indirect effect of X on Y

	Effect	Boot SE	Boot LLCI	Boot ULCI
Decision to outsource	.1587	.0697	.0251	.3012

Normal theory tests for indirect effect

Effect	SE	Z	P
.1587	.0462	3.4352	.0006

Level of confidence for all confidence intervals in output: 95.00

The model summary for direct effect, decision to outsource to each determinant i.e managers/owners trust, technical competence, resource availability and asset specificity while controlling for firm performance showed R values of 0.4784 F=89.6160 P-value <.0000, 0.7889 F=498.7620 P-value <.0000, 0.5923 F=163.2307 P-value <.0000 and 0.5902 F=161.4577 P-value <.0000 respectively indicates a relatively strong correlation between the predictor variables and the response decision to outsource. This means that variation in decision to outsource is attributed by 47.84% change in management/owner

trust, 78.89% in technical competence, 59.23% in resource availability and 59.02 change in asset specificity. The regression model showed co-efficiency values of 0.4734, 0.6145, 0.5539 and 0.6580 respectively while controlling for firm performance. When mediation is introduced the co-efficiency values changed to 0.3241, 0.1460, 0.3299 and 0.2967 respectively. This indicate that there is partial mediation.

The model summary for the direct effect, decision to outsource to combined determinants while controlling for the firm performance showed an R value of 0.773 indicates a relatively strong correlation between the predictor variables and the response decision to outsource. This means that the variation in the decision to outsource was attributed to 77.3% change in the predictor variables. The model was also found to be significant in predicting the change in the decision to outsource, $F = 448.2913$, p-value < 0.000. The regression model showed that the determinants have a positive and significant effect on the decision to outsource, 0.8999, p-value < 0.000 CI [0.8163, 0.9836]. This means that with each unit increase in the determinants (manager's trust, technical competencies, resource availability and asset specification), there would be 0.8999 unit increase in the decision to outsource.

The model summary for the direct effect, firm performance to the determinants and decision to outsource showed an R value of 0.7753 indicates a relatively strong correlation between the predictor variables and firm performance. This means that the variation in the decision to outsource was attributed to 77.53% change in decision to outsource and the determinants. The model was also found to be significant in predicting the change in firm performance, $F = 226.839$, p-value < 0.000. The regression model showed that the decision to outsource has a positive and significant effect on firm performance, 0.1764, p-value < 0.000 CI [0.0768, 0.2760]. This means that with each unit increase in the decision to outsource, there would be 0.1764 unit

increase in firm performance. The findings also showed that the determinants (manager's trust, technical competencies, resource availability and asset specification) have a positive and significant effect on firm performance, 0.6267, p-value < 0.000, CI [0.5108, 0.7427] meaning that there would be 0.6267 unit increase in firm performance with each unit increase in the determinants.

The model showed that the determinants have a positive and significant effect on firm performance, 0.7855, p-value < 0.000, CI [0.7106, 0.8604]. This implies that with each unit increase in the determinants, there would be 0.7855 increase in firm performance.

Finally, the findings provide the bootstrapped confidence intervals (95 %). The aim is to assess if zero (0) lies within the interval range. In this case, the TRUE indirect effect is 95% likely to range from 0.0251 to 0.3012, the estimated effect is 0.1587 (lying between these two values). Since zero does not occur between Boot LLCI and Boot ULCI, then the conclusion is that the indirect effect is significant, that is, decision to outsource has a positive and significant indirect effect on firm performance.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS OF THE STUDY

5.1 Introduction

This chapter introduces the synopsis of the findings and gives conclusions. It at that point gives proposals or recommendations of and further gives recommendations for future studies. In the outline is an introduction of the findings. The conclusion shows the study's endeavor to contribute to existing information while the recommendations propose what should be most ideal in regards to the area of study.

5.2 Summary of the Findings

5.2.1 Background information

The findings have showed that 83% of the SME owners/ managers are aged 35 years and below with 66.8% of them male. The findings have also showed that 45.1% of the SME owners/ managers have attained vocational level of education with others attaining either secondary, first degree, master's degree or primary education. Although there was diversity in terms of the SMEs, 19% of them offer telecommunication services while others are in the hospitality, retail, financial services and other sectors with over 70% of them generating less than KShs. 100,000 of income monthly. The findings have also showed that there was diversity in terms of the number of years that the SMEs have been in operation hence different experiences regarding outsourcing and firm performance.

5.2.2 Effect of independent variables on the decision to outsource

The determinants have a positive and significant effect on the decision to outsource, 0.8999, p-value < 0.000. This means that with each unit increase in the determinants (manager's trust, technical competencies, resource availability and asset specification),

there would be 0.8999 unit increase in the decision to outsource. This means that the hypothesis stating that there is no significant effect of the determinants on decision to outsource among SMEs is rejected.

More specifically, the manager's trust has a positive and significant effect on firm performance ($\beta_1 = 0.220$). In addition, the findings revealed that technical competencies has a positive and significant effect on firm performance ($\beta_2 = 0.250$). The findings also showed that resource availability has a positive and significant effect on firm performance ($\beta_3 = 0.179$ while asset specification has a positive and significant effect on firm performance ($\beta_4 = 0.328$).

5.2.3 Mediating role of decision to outsource

The regression model showed that the decision to outsource has a positive and significant effect on firm performance, 0.1764. The findings also showed that the determinants (manager's trust, technical competencies, resource availability and asset specification) have a positive and significant effect on firm performance, 0.6267. Finally, the findings showed the TRUE indirect effect is 0.1587 and indicated that the decision to outsource mediates the relationship between the manager's trust, technical competencies, resource availability and asset specification and firm performance.

5.3 Conclusion

The primary objective of this study was to assess the determinants of outsourcing of accounting functions and its effect on performance of SMEs in Kenya. This objective was guided by the following specific objectives: to determine the effect of owners/managers Trust in external accountant on the decision to outsource, to determine the effect of technical competence of the firm on the decision to outsource, to determine the effect of internal resource availability on decision to outsource, to

determine the effect of Asset specification on the decision to outsource and to determine the mediating role of decision to outsource on: the effect of risk of outsourcing on performance of SMEs, the effect of technical competence of the firm on performance of SMEs, the effect of internal resource availability on performance of SMEs and the effect Asset specification on performance of SMEs. The findings have showed that the decision to outsource mediates the relationship between the manager's trust, technical competencies, resource availability and asset specification and firm performance.

More specifically, although there were opportunities and reasons for outsourcing, many SMEs do not outsource because of their capacity to outsource, the capacity to find an external firm that meets the needs of the SMEs and trust issues related to outsourcing. Assessment of the total effects revealed that the manager's trust, technical competencies, resource availability and asset specification have a direct positive and significant effect on firm performance.

5.4 Recommendations

Switching to outsourcing of accounting enables companies to reduce overhead and focus on their core business activities, this improve growth and performance of SMEs for example outsourcing accounts payable improves accountability, reduces cost and effort in the SMEs which stimulate growth and hence performance of this businesses. External accountants can assist SMEs operating in a competitive environment, to integrate operational considerations within long-term plans to enhance their sustainability. Due to resource constrains SMEs cannot access professional accountants, outsourcing enable them to access this services, hence accurate information which enable them to make accurate decisions, this improves their performance.

By relying on outsourcing, SMEs can obtain the capabilities and competences they require from external service providers. This becomes advantageous to audit firms to increase the scope of their services to cater for different demands by SMEs. The SME's decision to outsource accounting services is based on the characteristics of the transaction and the interpersonal trust of the owner/manager in the external accountant such that the higher the perceived trust in professional accountants, the higher is the likelihood that the owner/managers of SMEs will choose to outsource their management accounting functions and vice versa.

Technical competence is the most valuable asset in an organization because owners use to improve organizational performance hence, by relying on outsourcing; SMEs can obtain the competence they need. Moreover, the reliance by SMEs on external accountants is indicated to be a result of the perceptions of SMEs that external accountants are competent and able to provide a value-for money service in providing accounting services. Thus, it is imperative for the external accountants or outsourced firms to enhance their competence levels.

The inability of SMEs to outsource is based on various factors and resources are one of the major factors involved in outsourcing services. It is thus important to have outsourcing firms to have the necessary resources to meet the varied demands of the SMEs.

5.5 Suggestions for Future Research

The main objective of this study is to examine determinants of outsourcing of accounting functions and its effect on performance of SMEs in Kenya. Specifically, the study sought to examine trust, technical competence, resource availability and asset specificity as determinants in outsourcing of accounting functions decisions and how it

affect performance of SMES in Kenya. This study was mainly centered on SMEs in Uasin Gishu County in Kenya. There is need to not only carry out further research on other sectors of the economy but also get the perspective of outsourcing and how this impacts on their profitability.

It is also imperative that there are other factors not covered in this study that can have a profound impact on the performance of the SMEs. Thus, there is need to further this study by exploring other factors that are important in order to increase the knowledge base. In addition, there is need to carry out research on the perspectives of the outsourcing firms so as to identify gaps as well as possible solutions to the outsourcing phenomenon.

REFERENCES

Adams, A., Lunt, P., & Cairns, P. (2007). A qualitative approach to HCI research. In: Cairns, Paul and Cox, Anna eds. *Research Methods for Human Computer Interaction.* Cambridge, UK: Cambridge University Press, pp. 138–157.

Agarwal, S., & Ramaswami, S.N. (1992). The choice of foreign market entry mode: impact of ownership, location and internationalization factors. *Journal of International Business Studies* 23(1): 1–27.

Aubert, B., Patry, M., & Rivard, S. (2004). Assessing the risk of IT outsourcing. Paper presented at the 31st Annual Hawaii International Conference on System Sciences, Hawaii.

Barney, J. B. (1986). 'Organizational culture: can it be a source of sustained competitive advantage?' *Academy of Management Review*, **11**, 656–65.

Barney, J. B. (1991). Firm resources and sustained competitive advantage. *Journal of Management Accounting Research*, 17(1), 99–120.

Barney, J. B. (1999). How a firm's capabilities affect boundary decisions. *Sloan Management Review*, 40(3): 137-145

Barthelemy, K., & Geyer, D. (2003). An empirical investigation of IT outsourcing versus quasi-outsourcing in France and Germany. *Information & Management*, 42(4), 533–542

Bennett, R., & Robson, P. (1999). The use of external business advice by SMEs in Britain. *Entrepreneurship and Regional Development*, 11(2), 155–180.

Berry, A. J., Sweeting, R., & Goto, J. (2006). The effect of business advisers on the performance of SMEs. *Journal of small Business and Enterprise Development*, 13(1), 33-47

Blackburn, R., & Jarvis, R. (2010). *The role of small and medium practices in providing business support to small and medium-sized enterprises*. Information Paper, International Federation of Accountants, April.

Bozzurro, L., Zhang, E., & Costa M da (2008). *The process of trust creation between SMEs and their consulting accountants.* International Business and Economics Program Bachelor Dissertation.

Breen, A., Sciulli, N., & Calvert, C. (2003). *The Role of the External Accountant in Small Firms'* Paper presented at the 16th Annual SEAANZ Conference, Ballarat, Australia.

Brockman, B. K., Jones, M. A., & Becherer, R. C. (2012). "Customer Orientation and Performance in Small Firms: Examining the Moderating Influence of Risk-Taking, Innovativeness, and Opportunity Focus," *Journal of Small Business Management* 50(3), 429–446.

Brouthers, K., & Brouthers, L. (2003). Why service and manufacturing entry mode choices differ: The influence of transaction cost factors, risk and trust. *Journal of Management Studies*, 40(5), 1179–1204.

Caldeira, M.M., & Ward, J.M., (2003). Using resource-based theory to interpret the successful adoption and use of information systems and technology in manufacturing small and medium-sized enterprises. *European Journal of Information System*, Vol 12(2). 127-141.

Caloghirou, Y., Kastelli, I., & Tsakanikas, A. (2004). Internal capabilities and external knowledge sources: complements or substitutes for innovative performance? *Technovation,* 24(1), 29-39

Carey, P., Subramaniam, N., & Ching, K. C. W. (2005). Internal audit outsourcing in Australia. *Accounting and Finance*, 46, 11-30

Carey, P., Subramaniam, N., & Ching, K. C. W. (2006). Internal audit outsourcing in Australia. *Accounting and Finance*, 46, 11-30

Chang, Y.-C., Chen, Y.-C., & Kuo, T.-K. (2009). Strategic technology sourcing in corporate ventures A study of Taiwanese pharmaceutical firms. *International Journal of Entrepreneurial Behaviour & Research*, 15(5), 497-517.

Cho, H., & Pucik, V. (2005). Relationship between innovativeness, quality, growth, profitability, and market value. *Strategic Management Journal, 26*(6), 555-575. doi: 10.1002/smj.461

Coase, R. (1937). The Nature of the Firm. *Economica,* 4, 386-405

Collis, J., & Jarvis, R. (2002), 'Financial Information and the Management of Small Private Companies', *Journal of Small Business and Enterprise Development*, 9 (2): 100–10

Deakins, D., Logan, D., & Steele, L. (2001). *The Financial Management of the Small Enterprise,* ACCA research report no. 64 (London: CAET)

Devi, S. S., & Samujh, R. H. (2010). *Accountants as Providers of Support and Advice to SMEs in Malaysia* (Research report No. 118). ACCA, London.

Dibbern, J., & Heinzl, A. (2009). Outsourcing of information systems in small and medium sized enterprises: A test of a multi-theoretical causal model. *Wirtschaftsinformatik* 43(4): 339–350.

Domberger, S., & Fernandez, P. (1999). Public-private partnerships for service delivery. *Business Strategy Review* 10(4): 29–39.

Doran, M. (2006). Bean counter or business adviser? An exploratory study of changing times for the accounting practitioner in Ireland. *The Irish Accounting Review,* 13(1), 23-46

Dorasamy, M., Marimuthu, M., Jayabalan, J., Raman, M., & Kaliannan, M. (2010). Critical factors in outsourcing of accounting functions in Malaysia small medium-sized enterprises (SMEs). *Kajian Malaysia*, Vol. 28 No.2

Doving, E., & Nordhaug, O. Gooderham, P. N., Tobiassen, A., (2008). Accountants as sources of business advice for small firms. *International Small Business Journal*, 22(1), 5-22

Dyer, J. H., & Chu, W. (2003). The Role of Trustworthiness in Reducing Transaction Costs and Improving Performance: Empirical Evidence from the United States, Japan, and Korea, in: *Organization Science*, Vol. 14, 1, p. 57-68.

Dyer, L. M., & Ross, C. A. (2008). Seeking advice in a dynamic and complex business environment: Impact on the success of small firms. *Journal of Developmental Entrepreneurship*, 13(2), 133-149.

Eisenhardt K.M. (2009). Agency Theory: An Assessment and Review. *Academy of Managwneni Review*. 1989. VoL 14. No. i, S7-7i

Eramilli, K.M., & Rao, C.P. (1993). Service firms' international entry mode choice: a modified transaction-cost analysis approach. *Journal of Marketing* 57(3): 19–38.

Espino-Rodríguez, T. F., & Padrón-Robaina, V. (2004). Outsourcing and its impact on operational objectives and performance: a study of hotels in the Canary Islands. *Hospitality Management,* 23(287-306)

Espino-Rodríguez, T. F., & Padrón-Robaina, V. (2005). A resource-based view of outsourcing and its implications for organizational performance in the hotel sector. *Tourism Management,* 26, 707–721.

Espino-Rodriguez, T.F., & Rodriguez-Diaz, M. (2008), "Effects of internal and relational capabilities on outsourcing: an integrated model", *Industrial Management & Data Systems,* Vol. 108 No. 3, pp. 328-45.

Everaert, P., Sarens, G., & Rommel, J. (2006). Outsourcing of Accounting Tasks in SMEs: An extended TCE Model (Working Paper No. 2004/403). Gent: Univeersiteit Gento.

Everaert, P., Sarens, G., & Rommel, J. (2007). Sourcing strategy of Belgian SMEs: empirical evidence for the accounting services. *Production Planning & Control*, 18(8), 716-725.

Everaert, P., Sarens, G., & Rommel, J. (2010). Using Transaction Cost Economics to explain outsourcing of accounting. *Small Bus Econ,* 35(1), 93–112

Gilley, K. M., & Rasheed, A. (2000). Making more by doing less: an analysis of outsourcing and its effects on firm performance. *Journal of Management,* 26(4), 763– 790.

Gilley, K. M., Greer, C. R., & Rasheed, A. A. (2004). Human resource outsourcing and organizational performance in manufacturing firms. *Journal of Business Research,* 57, 232-240.

Glick, W.H., Washburn, N.T., & Miller, C.C. (2005, August). The myth of firm performance. Proceedings of the Annual Meeting of American Academy of Management. Honolulu, Hawaii.

Gooderham, P. N., Tobiassen, A., Doving, E., & Nordhaug, O. (2004). Accountants as sources of business advice for small firms. *International Small Business Journal*, 22(1), 5-22.

Gottschalk, P. & Solli-Sæther, H. (2005). 'Critical success factors from IT outsourcing theories: An empirical study', *Industrial Management & Data Systems*, **105**(6): 685-702.

Gottschalk, P., & Solli-Sæther, H. (2006). Maturity model for IT outsourcing relationships. *Industrial Management & Data Systems*, 106(2), 200-212

Greenberg, P. S., Greenberg, R. H., & Antonucci, Y. L. (2008). The role of trust in the governance of business process outsourcing relationships A transaction cost economics approach. *Business Process Management Journal*, 14 (5), 593-608.

Hadjimanolis, A. (2000). A resourced-based view of innovativeness in small firms. *Tech Anal Strateg Manage*, 12(2), 263– 292, doi:10.1016/S0148-2963(02)00304-1, http://dx.doi.org/10.1016/S0148-2963(02)00304-1

Hansen, M.H., & Morrow, J.L. (2003). Trust and the decision to outsource: Affective responses and cognitive processes. *International Food and Agribusiness Management Review*, 6(3): 40-69.

Haveckin, B. (2012), Information Technology outsourcing. *Momme J., Framework for outsourcing manufacturing: strategic and operational implications, Computers in Industry, 49 (2002) pp. 59.75.*

IFAC. (2010). The role of small and medium practices in providing business support to small- and medium sized enterprises. Information Paper. *International Federation of Accountants*, April.

ILO. (2003). An Employment Strategy for the Islamic Republic of Iran: A Report Prepared for The Government of The Islamic Republic of Iran in Collaboration with the Ministry Labour and Social Affairs under UNDP SPPD funding. [Online] Available: http://www.ilo.org/public/english/region/asro/newdelhi/download/publ/iran/strategy_rep.pdf

Ismail, N. A., & King, M. (2002). Firm performance and AIS alignment in Malaysian SMEs. *International Journal of Accounting Information Systems*, 6, 241– 259

Jayabalan, J., Raman, M., Dorasamy, M., & Ching, N. K. C. (2009). Outsourcing of Accounting Functions amongst SME Companies in Malaysia: An Exploratory Study. *Accountancy Business and the Public Interest,* 8(2), 96-114

Jiang, B., Belohlav, J. A., & Young, S. T. (2007). Outsourcing impact on manufacturing firms' value: Evidence from Japan. *Journal of Operations Management,* 25, 885 900

Jones, T. M. (1995). Instrumental stakeholder theory: A synthesis of ethics and economics. *Academy of Management Review,* 20: 404-37.

Kakabadse, A., & Kakabadse, N. (2002). Trends in outsourcing: Contrasting USA and Europe. *European Management Journal* 20(2): 189–198

Kamyabi, Y., & Devi, S. (2011). The impact of accounting outsourcing on Iranian SME performance: Transaction Cost economics and resource-based perspectives. *World Applied Sciences J.*, 15(2): 244-252.

Kamyabi, Y., & Devi, S. (2011b). Using transaction cost economics and resource-based views in management accounting outsourcing: An empirical study of Iranian SMEs*, Middle- East Journal of Scientific Research* 10 (1): 87-98,

Kamyabi, Y., & Devi, S. (2011c). An empirical investigation of accounting outsourcing in Iranian SMEs: Transaction cost economics and resource-based views. *International Journal of Business and Management* 6 (3): 81-94.

Kamyabi, Y., & Devi, S. (2011c). Use of professional accountants' advisory services and its impact on SME performance in an emerging economy: A resource-based view. *J. Management and Sustainability*. 1(1): 43-55.

Kamyabi, Y., & Devi, S. (2011d). Using Transaction Cost Economics and Resource–Based views in Management Accounting Outsourcing: An empirical study of Iranian SMEs. *Middle East Journal of Scientific Research, 10*(1), 87–98.

Kamyabi, Y., & Devi, S. (2011e). Outsourcing of accounting functions in the context of SMEs in emerging economies: Transaction cost economics perspective. *Australian Journal of Basic and Applied Sciences, 5*(11), 1696–1703

Kim, J., So, S., & Lee, Y. (2007). The Effects of Trust on the Intention of Adopting Business Process Outsourcing: An Empirical Study. *IJCSNS International Journal of Computer Science and Network Security*, 17(10).

Kotabe, M., & Mol, M.J. (2009). Outsourcing and financial performance: A negative curvilinear effect, *Journal of Purchasing and Supply Management*, Pages 205–213.

Krell, E. (2006). What's wrong with outsourcing (and how to fix it). *Business Finance Magazine* August: 18–27

Lamminmaki, D. (2005). Why do hotels outsource? An investigation using asset specificity. *International Journal of Contemporary Hospitality Management*, 17(6), 516-528.

Lamminmaki, D. (2007). Accounting and the management of outsourcing: An empirical study in the hotel industry. *Management Accounting Research,* 19, 163–181

Lee, J.-N., Huynh, M. Q., & Hirschheim, R. (2008). An integrative model of trust on IT outsourcing: Examining a bilateral perspective. *Inf Syst Front*, 10, 145–163

Leung, P., Raar, J., & Tangey, G. (2008). *Accounting Services and SMEs:An Australian Study* (No. 99). Melbourne, Australia: The Association of Chartered Certified Accountants

Li, W., Veliyath, R. & Tan, J. (2013). Network characteristics and firm performance: An examination of the relationships in the context of a cluster, *Journal of Small Business Management* 51(1), 1–22.

Longenecker, J. G., Moore, C. W., Petty, J. W., & Palich, L. E. (2003). *Small business management: An entrepreneurial emphasis*. London: Thomson South-Western

Madhok, A. (2002). Reassessing the fundamentals and beyond: Ronald Coase, the transaction cost and resource-based theories of the firm and institutional structure of production. *Strategic Management Journal*, 23, 535–550

Mahmoodzadeh, E., Jalalinia, S., & Yazdi, F. N. (2009). A business process outsourcing framework based on business process management and knowledge management. *Business Process Management Journal,* 15(6), 845-864.

Makino, S., Neupert, K.E. (2000). National culture, transaction costs, and the choice between joint venture and wholly owned subsidiary. *Journal of International Business Studies* 31(4): 705–714

Mansury, M., & Love, J. (2008). Innovation, productivity and growth in US business services: A firm-level analysis. Technovation, 28, 52-62.

Marlow, S., & Carter, S. (2005). *Access to finance: women's enterprise and the role of the accountant (No. 90).* London: The Association of Chartered Certified Accountants

Marriott, N., & Marriott, P. (2000). Professional accountants and the development of a management accounting service for the small firm: Barriers and possibilities. *Management Accounting Research* 11(4): 475–492

Marriott, N., Marriott, P., Collis, J. and Son, D. D. (2008). *The Accountant and the Provision of Financial Advice to UK Smaller Companies* (Blackpool: British Accounting Association)

Marshall, D., McIvor, R., & Lamming, R. (2007). Influences and outcomes of outsourcing: Insights from the telecommunications industry. *Journal of Purchasing and Supply Management*, 13(4), 245-26

Martin, C. (2005). *Accountancy practices and the provision of ownership succession advice (N0. 85).* The Association of Chartered Certified Accountants.

Mashayekhi, B., & Mashayekh, S. (2008). Development of accounting in Iran. *The International Journal of Accounting*, 43, 66–86.

Masinga, E. K., & K D (2014). Effects of Outsourcing Decision on Organisation Performance In The Manufacturing Industry Case Of Unilever Group Limited In Kenya. *International Journal of Business & Law Research 2(4):53-72, Oct-Dec*

McIvor, R. (2009). How the transaction cost and resource-based theories of the firm inform outsourcing evaluation. *Journal of Operations Management, 27, 45-63*

McIvor, R., Humphreys, P., McKittrick, A., & Wall, T. (2009). Performance management and the outsourcing process lessons from a financial services organisation. *International Journal of Operations & Production Management, 29 (10), 1025-1048*

McNally, R. C., & Griffin, A. (2004). Firm and individual choice drivers in make–or–buy decisions: a diminishing role for transaction cost economics? *The Journal of Supply Chain Management, 40*(1), 4–17. http://dx.doi.org/10.1111/j.1745-493X.2004.tb00252.x

Murray, J., & Kotabe, M. (1995). Sourcing strategies of U.S. service companies: A modified transaction–cost analysis. *Strategic Management Journal, 20*(9), 791–809. http://dx.doi.org/10.1002/(SICI)1097-0266(199909)20:9<791::AID-SMJ49>3.0.CO;2-U

Naderian, H. (2010). Several obvious and significant differences in professional services in Iran. *Journal of Iranian Certified Public Accountants,* 8, 44-45

Nicholson, B., Jones, J., & Espenlaub, S. (2006). Transaction costs and control of outsourced accounting: Case evidence from India. *Management Accounting Research,* 17, 238–258

OECD. (2004). The impact of the global crisis on SME and entrepreneurship financing and policy responses. Centre for Entreprenuership, SMEs and Local Development. *Organisation for Economic Co-operation and Development.*

OECD. (2009). The impact of the global crisis on SME and entrepreneurship financing and policy responses. Centre for Entreprenuership, SMEs and Local Development. *Organisation for Economic Co-operation and Development.*

Penrose, E. T. (1959). *The Theory of the Growth of the Firm*. New York: John Wiley.

Penrose, E.T. (1959). *The theory of growth of the firm.* London: Basil Blackwell

Poppo, L., & Zenger, T. (1998). Testing alternative theories of the firm: transaction cost, knowledge-based, and measurement explanations for make-or-buy decisions in information services. *Strategic Management Journal,* 19(9), 853-877.

Reeves, K. A., Caliskan, F., & Ozcan, O. (2010). Outsourcing distribution and logistics services within the automotive supplier industry. *Transportation Research Part E, 46,* 459–468. http://dx.doi.org/10.1016/j.tre.2009.10.001

Richard, P.J., Devinney, T., Yip, G., & Johnson, G. (2009). Measuring organizational performance: towards methodological best practice *Journal of Management*, vol 35, no. 3, pp. 718-804. DOI: 10.1177/0149206308330560

Rieple, A., & Helm, C. (2008). Outsourcing for competitive advantage: An examination of seven legacy airlines. *Journal of Air Transport Management*, 14, 280– 285.

Rodriguez, T. F. E., & Diaz, M. R. (2008). Effects of internal and relational capabilities on outsourcing: An integrated model. *Industrial Management & Data Systems* 108(3): 328–345

Rungtusanatham, M., Rabinovich, E., Ashenbaum, B., & Wallin, C. (2007). Vendor owned inventory management arrangements in retail: an agency theory perspective. *Journal of Business Logistics*, 28 (1), 111-135.

Samujh, R. H., & Devi, S. S. (2008). *Professional accountants enabling SMEs reach their potential, International Colloquium on Asian Business.* Bangkok, Thailand; 30 June–3 July, 1–25.

Scott, J. M., & Irwin, D. (2009). Discouraged advisees? The influence of gender, ethnicity, and education in the use of advice and finance by UK SMEs. *Environment and Planning C: Government and Policy,* 27, 230 -245

Shang, J.-K., Hung, W.-T., & Wan, F.-C. (2008). Service outsourcing and hotel performance: three-stage DEA analysis. *Applied Economics Letters*, 15, 1053– 1057.   doi:10.1080/13504850600993523, http://dx.doi.org/10.1080/13504850600993523

Sian, S., & Roberts, C. (2009). UK small owner-managed businesses: accounting and financial reporting needs. *Journal of small Business and Enterprise Development,* 16(2), 289-305.

Sian, S., & Roberts, C. (2009). UK small owner-managed businesses: accounting and financial reporting needs. *Journal of small Business and Enterprise Development,* 16(2), 289-305.

Speklé, R. F., van Elten, H. J., & Kruis, A.-M. (2007). Sourcing of internal auditing: An empirical study. *Management Accounting Research,* 18(1), 102-124

Stanger, A. M. J. (2004). Gender-comparative use of small business training and assistance: A literature review. *Education & Training*, 46(8/9), 464, doi:10.1108/00400910410569588, http://dx.doi.org/10.1108/00400910410569588

Stanworth, J., & Gray, C. (eds). (1992). *Bolton 20 Years On.* Paul Chapman, London.

Stratman, J. K. (2008). Facilitating offshoring with enterprise technologies: reducing operational friction in the governance and production of services. *Journal of Operations Management,* 26(2), 275–287.

Susela, S. D., & Helen, R., S. (2010). Accountants as provider of support and advice to SMEs in Malaysia. Certified Accountants Education Trust, *Association of Chartered Certified Accountants*. London.

Targett, D. Baden-Fuller, C., and Hunt, B. (2000). Outsourcing to outmanoeuvre. *European Management Journal*, Vol. 18 No. 3, pp. 285-95

Teng, T.C., Grover, V., & Cheon, M.J. (1996). The effect of service quality and partnership on the outsourcing of information systems functions. *Journal of Management Information Systems*, 12, 4, 89-117

Thouin, M.F., Hoffman, J.J., & Ford, E.W. (2009), "IT outsourcing and firm-level performance: a transaction cost perspective", *Information & Management*, Vol. 46 No. 8, pp. 463-9

UNIDO. (2003). To enhance the contribution of an efficient and competitive small and medium-sized enterprise sector to industrial and economic development in the Islamic republic of Iran [Online] Available: http://www.unido.org/fileadmin/import/18229_AbsFinal.pdf

United Nations Conference on Trade and Development. 2000. *Promoting transparency and financial disclosure: Accounting by small and medium-sized enterprises.* http://www.unctad.org/en/docs/c2isarl3.en.pdf

Verreynne, M., & Meyer, D. (2010). Making Strategy at Different Stages of the Industry Life Cycle—Relationships with Small Firm Performance. *Small Business Economics 35*(4), 399–416.

Verreynne, M.-L., & Meyer, D. (2008). Small business strategy and the industry life cycle. *Small Business Economics,* Vol. Doi: 10.1007/s11187-008-9165-3 No., pp. 1-18.

Verwaal, E., Verdú, A.J., & Recter, A. (2008). Transaction costs and organizational learning in strategic outsourcing relationships. *Int. J. Technology Management*, 41(1/2): 38-54.

Victor-A.T., & Dumitru-Alexandru, B. (2012). Outsourcing. The Concept. *Theoretical and Applied Economics Volume XIX (2012), No. 6(571), pp. 51-58*

Watjatrakul, B. (2005). Determinants of IS sourcing decisions: A comparative study of transaction cost theory versus the resource-based view. *Journal of Strategic Information Systems*, 14(4), 389–415.

Wernerfelt, B. (1984). 'A resource-based view of the firm'. *Strategic Management Journal*, **5**, 171–80.

Weru, W.K (2006). *Outsourcing of the accounting function among the listed firms at the NSE,* Unpublished MBA project, UON

Williamson O E. (1979). Transaction-Cost Economics: The Governance of Contractual Relations. *Journal of Law and Economics*, Vol. 22, No. 2 (Oct., 1979), pp. 233-261 http://www.jstor.org/stable/725118?origin=JSTOR-pdf

Williamson, O. (1985). *The economic institutions of capitalism*. New York: Free Press.

Williamson, O. E. (1975). *Markets and Hierarchies: Analysis and Antitrust Implications*. New York, NY: Free Press

Williamson, O. E. (1981). The economics of organization: The transaction cost approach. *American Journal of Sociology*, 87(3): 548-577

Worrall, L. (2007). Transforming regional economic performance through business transformation. *International J. Management Practice, 2*(4), 324–344. http://dx.doi.org/10.1504/IJMP.2007.012749

Wuyts, S., & Geyskens, T. (2005). 'The Formation of Buyer-Supplier Relationships: Detailed Contract Drafting and Close Partner Selection.' *Journal of Marketing* 69 (4): 103–17.

Ya, N. A., & Bretschneider, S. (2007). The decision to contract out: A study of contracting for e-government services in state governments. *Public Administration Review* 67(3): 531–544.

Yamane, T. (1973). *Statistics: an introductory analysis.* New York: Harper & Row.

Zarrella, E., & L. Huckhai. (2004). *KPMG - Asia Pacific Outsourcing Survey. Who is conducting the orchestra?* www.kpmg.com.sg/publications/irm_AspacOutsourcingSurvey2004.pdf (accessed 02April 2017).

Zoran P. (2007). *Outsourcing Process and Theories.* Centre for Technology, Economics & Management Technical University of Denmark, Building 421 2800 Kongens Lyngb DENMARK

APPENDICES

Appendix I: Questionnaire

The purpose of this questionnaire is to obtain information that is relevant to my research title: ***DETERMINANTS OF OUTSOURCING OF ACCOUNTING FUNCTIONS AND ITS EFFECT ON PERFORMANCE OF SMEs IN UASINGISHU.*** The information provided will be used purely for academic and will be treated with utmost confidentially. I humbly request you to provide the information sought by this questionnaire as candidly as possible. In case you need to verify, clarify or add the information you have given please feel free to use this cell-phone number 0720031704

SECTION A: BIO-DATA

1. Age below 25 yrs (   )   26-30yrs (   )   31-35 yrs (   )   36-40yrs (   ) 41-45 ( ) 46-50 ( ) Above 50 yrs (   )

2. Your Gender. Please tick.   Male (   )   Female (   )

3. Highest level of education attained

Primary education ( )   Secondary Education ( )   Vocational education ( )

first degree ( ) Masters (   ) others specify ( )

4. What type of business do you engage in?

Financial services ( )

Retail ( )

Telecommunication ( )

Agriculture ( )

Hospitality ( )

Professional services ( )

Workshop services ( )

Others specify_____

5. Business Income level per month

Below shillings 10000 (   )   11000 -50,000 (   )   51,000-90, 000 (   )

Above 100,000 (   )

6. What is your position in the business? Owner ( ) Manager ( ) employee ( )

7. How long has the business been in existence?

Less than 1yr (   ) 1-2 yrs (   ) 2-3yrs (   ) 3-5 yrs (   ) 5-10 yrs (   )   over 10 yrs (   )

SECTION B: DECISION TO OUTSOURCE

In this section the study is interested in your view on decision to outsource accounting functions. Read each of the statements and answer by ticking in the appropriate category that best fits your opinion. The categories are scale of 1-5 where: 5-Strongly Agree, 4- Agree, 3-Neutral, 2-Disagree, 1- Strongly Disagree

DO1	My firm outsource external accountant to file VAT returns	1	2	3	4	5
DO2	My firm outsource eternal accountant to prepare financial statements	1	2	3	4	5
DO3	My firm outsource external accountant to prepare payroll	1	2	3	4	5
DO4	My firm outsource external accountant to undertake audit work	1	2	3	4	5
DO5	My firm outsource external accountant to undertake profit analysis	1	2	3	4	5
DO6	My firm outsource external accountant to give financial advice	1	2	3	4	5
DO7	My firm outsource external accountant to file tax returns	1	2	3	4	5

SECTION C: OWNER'S/MANAGER'S TRUST

In this section the study is interested in your view of trust towards external accountant. Read each of the statements and answer by ticking in the appropriate category that best fits your opinion. The categories are scale of 1-5 where: 5-Strongly Agree, 4- Agree, 3-Neutral, 2-Disagree, 1- Strongly Disagree

T1	We have confidence that the external accountant will inform correctly	1	2	3	4	5
T2	I feels that external accountant care about what happens to us.	1	2	3	4	5
T3	The relationship between the owner-manager and the external accountant is based on trust	1	2	3	4	5
T4	I feel that the external accountant will perform his duties correctly	1	2	3	4	5

SECTION D: TECHNICAL COMPETENCIES

In this section the study is interested in your view of technical competencies of external accountant. Read each of the statements and answer by ticking in the appropriate category that best fits your opinion. The categories are scale of 1-5 where: 5-Strongly Agree, 4- Agree, 3-Neutral, 2-Disagree, 1- Strongly Disagree

TC1	The external accountant has appropriate qualification	1	2	3	4	5
TC2	The external accountant has knowledge about the industry	1	2	3	4	5
TC3	The accountant has necessary special skills	1	2	3	4	5
TC4	The accountant has necessary technological expertise	1	2	3	4	5
TC5	The accountant has specialization in the industry	1	2	3	4	5
TC6	The accountant has management skills	1	2	3	4	5

SECTION E: RESOURCE AVAILABILITY

In this section the study is interested in your view of resource availability by external accountant. Read each of the statements and answer by ticking in the appropriate category that best fits your opinion. The categories are scale of 1-5 where: 5-Strongly Agree, 4- Agree, 3-Neutral, 2-Disagree, 1- Strongly Disagree

RF1	The firm have enough staff to meet our obligation	1	2	3	4	5
RF2	The firm have qualified staff	1	2	3	4	5
RF3	The audit firm have enough time to perform our duties on time	1	2	3	4	5
RF4	The firm have enough infrastructure	1	2	3	4	5
RF5	The firm infrastructure meets current business environment	1	2	3	4	5

SECTION F: ASSET SPECIFICATION

In this section the study is interested in your view of your asset specification. Read each of the statements and answer by ticking in the appropriate category that best fits your opinion. The categories are scale of 1-5 where: 5-Strongly Agree, 4- Agree, 3-Neutral, 2-Disagree, 1- Strongly Disagree

AS1	To obtain the accounting functions the accountant needs to acquire company specific information	1	2	3	4	5
AS2	The accounting software is custom-tailored to our firm	1	2	3	4	5
AS3	To perform the advisory services the accountant needs to obtain company-specific information	1	2	3	4	5
AS4	The way we perform the accounting functions is unique to our firm	1	2	3	4	5
AS5	It would be costly in terms of time and resources to switch to an external accountant at the end of the financial year.	1	2	3	4	5

SECTION G: PERFORMANCE OF SMEs.

In this section, the study is interested in your opinion on how the business has been performing. Read each of the statements and answer by ticking in the appropriate category that best fits your opinion. The categories are scale of 1-5 where: 5-Strongly Agree, 4- Agree, 3-Neutral, 2-Disagree, 1- Strongly Disagree

G 1	There has been growth in sales in relation to your expectations	1	2	3	4	5
G 2	There has been growth in sales in relation to your competitors	1	2	3	4	5
G 3	There has been growth in profits in relation to your expectations	1	2	3	4	5
G4	There has been growth in profit level in relation to your Competitors	1	2	3	4	5
G 5	The number of our employees has increased	1	2	3	4	5
G 6	There has been increased market size in new markets in relation to your competitors	1	2	3	4	5
G 7	There has been growth in capital from business operations	1	2	3	4	5
G 8	We have successfully Improved our efficiency	1	2	3	4	5
G 9	We have been successful in creation of positive reputation	1	2	3	4	5
G10	Increase in perception of customer satisfaction	1	2	3	4	5
G11	We have high level of customer loyalty	1	2	3	4	5
G 12	We have high level of new customers	1	2	3	4	5
G 13	We have high ability to develop new products	1	2	3	4	5

THANK YOU