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# The Impact of Capital Investment Decisions on the Growth of Small and Medium Enterprises: A Case Study of Nairobi City County's Central Business District, Kenya

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***Abstract***

*Small and Medium Enterprises (SMEs) play a pivotal role in Kenya's economic growth, driving job creation and development as envisioned in Vision 2030. Despite their importance, many SMEs in Nairobi County's Central Business District face challenges due to limited capital, hindering their growth and economic potential. This study aimed to examine the effect of capital investment decisions on SME growth in this region. Specifically, it assessed the impact of expansion, replacement, modernization, contingency, and diversification investment decisions. The research was anchored on contingency theory, cash flow theory, and acceleration theory, using a descriptive research design. Out of 1,367 registered SMEs, 310 were sampled using the Yamane technique, with data collected through questionnaires. Findings indicated that expansion, replacement, modernization, and contingency decisions significantly influenced SME growth, while diversification had an insignificant impact. Overall, these factors explained 85.7% of the variance in SME growth. The study recommended that SMEs adopt strategic investment decisions and urged the Kenyan government, along with the Micro and Small Enterprises Authority, to establish venture capital exit policies and a comprehensive regulatory framework to address venture capital challenges in Kenya.*

***Keywords:*** *Capital, Contingency, Diversification, Expansion, Investment decisions, Modernization, Replacement*

## 1.1 Introduction

Small and Medium-scale Enterprises (SMEs) play pivotal roles in fostering industrialization and economic growth in both developed and developing countries (Constantin, 2019). In developing nations, SMEs contribute significantly to grassroots economic development and sustainable growth, sparking a rise in entrepreneurial activities (Higgs & Hill, 2019). SMEs enhance per capita income and output, promote the efficient use of resources, ensure regional economic balance through industrial dispersal, and generate employment opportunities (Mohammed, Oben'Umar, & Nzelibe, 2016; Constantin, 2019). Moreover, SMEs fuel innovation, foster competitiveness on a global scale, and contribute to domestic and export revenues (Bagheri, Mitchelmore, Bamiatzi, & Nikolopoulos, 2019; Higgs & Hill, 2019). SME development is critical in poverty reduction efforts, serving as a cornerstone for sustained economic growth, and its success has far-reaching impacts on societal well-being (Kamara, 2017).

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However, SMEs in developing countries face significant challenges in accessing financial resources. According to the International Finance Corporation (IFC), there is a $5.2 trillion unmet financing need for 65 million micro, small, and medium-sized enterprises (MSMEs) in developing countries, representing 40% of the total MSMEs globally (World Bank, 2023). The finance deficit is most pronounced in East Asia and the Pacific (46%), followed by Latin America and the Caribbean (23%), and Europe and Central Asia (15%). Latin America and the Caribbean, along with the Middle East and North Africa, have the highest financing gap relative to potential demand, with deficits of 87% and 88%, respectively.

In sub-Saharan Africa, the World Bank estimates that there are between 365 and 445 million MSMEs, of which 25-30 million are formal SMEs, 55-70 million are formal micro-enterprises, and 285-345 million are informal enterprises. Formal SMEs account for up to 60% of total employment and up to 40% of Gross Domestic Product (GDP) in emerging economies (World Bank, 2018). Including informal SMEs substantially increases these figures. Formalizing informal SMEs can yield significant benefits, including improved access to credit and government services for businesses, and increased tax revenues and regulation for the broader economy. Enhancing financial accessibility for SMEs and identifying new sources of capital for investment are critical to expanding this sector and boosting employment (Abbasi, Wang, & Abbasi, 2017).

Despite the importance of financing, many SMEs struggle to access formal credit. About half of formal SMEs are unable to secure formal credit, hampering their investment and growth potential (Nguyen, Nguyen, Troege, & Nguyen, 2020). The situation is worse for micro and informal enterprises, with approximately 70% of MSMEs in sub-Saharan Africa lacking access to formal credit (Nguyen et al., 2020; World Bank, 2023). This lack of access to finance forces SMEs to rely on internal funds or cash from friends and family to sustain their operations. In Africa, the credit gap for informal and formal SMEs is estimated to be as high as $2.6 trillion, with formal SMEs alone facing a $1.2 trillion shortfall (World Bank, 2023). This financial strain hinders the ability of SMEs to make sound investment decisions in a highly competitive business environment (Nguyen et al., 2020).

In Kenya, investment accounted for 20.3% of the country's nominal GDP in December 2021, up from 19.7% in the previous year. Lemmon and Zender (2019) argue that SMEs determine their capital structure based on factors that influence the costs and benefits of debt and equity financing. SMEs must choose the right

balance of equity and debt to fund their operations, with investment decisions that lead to higher survival rates, lower risks, and enhanced growth (Cosenz & Bivona, 2020). In developing countries, however, the investment strategies of SMEs are often erratic and unrealistic, posing a challenge to both business practitioners and academic researchers (Idehen, 2021). Organizations that adopt appropriate investment strategies and capital decisions are more likely to improve productivity and operational performance.

Capital investment decisions refer to the process of allocating funds towards acquiring assets expected to generate future returns, as noted by Machuki (2014). Investments aim to enhance wealth, and they may take various forms, including ownership of property, businesses, or savings, as suggested by Parr (2017). Decision-making in this context begins with recognizing an investment-related opportunity or issue and ends with the approval of the investment project (Reidy, 2018). While investors are generally risk-averse, risk is an inevitable part of decision-making. According to Ernst, Hoyer, Krafft, and Soll (2017), firms often employ strategies like developing new products, entering new markets, or starting new business lines to anticipate future benefits. Therefore, capital investment decisions involve determining how best to invest current assets into long-term assets for optimal returns (Eze & Onoh, 2018; Mavis et al., 2020). These decisions are significant as they impact a firm's growth and risk. They are also irreversible and require a substantial commitment of funds (Reidy, 2018).

Capital investment decisions are essential for businesses' long-term success, given their role in the long-term allocation of financial resources (Chan, 2010; Mweresa & Muturi, 2018). These decisions include investing in new projects, reassessing capital allocated to existing projects, rationing capital across divisions, or acquiring other firms (Mweresa & Muturi, 2018). These decisions, also known as capital budgeting or capital expenditure decisions, significantly influence a firm's value, profitability, and risk (Khan, 2019). Unlike short-term investments, capital investment decisions require firms to commit large capital expenditures for sustained future benefits.

Investment decisions typically fall into categories such as expansion, replacement, modernization, diversification, and contingency (Mørch et al., 2017; Pot et al., 2018). Expansion involves adding new products or operations or increasing capacity (Pot et al., 2018), while replacement decisions focus on improving efficiency and reducing costs by replacing outdated products in response to environmental changes (Musau, 2016; Amadi-Echendu et al., 2019). Expansion decisions consider factors such as

depreciation, interest expenses, operating costs, and potential lost revenues. Contingency decisions reflect the understanding that no single approach is universally optimal for organizing businesses or making decisions. The best course of action depends on the internal and external circumstances a company faces. Decision-making, as noted by Jin, Shu, and Zhou (2019), is influenced by technical knowledge and goal consensus. High technical knowledge with low goal consensus may result in greater uncertainty in problem identification, while individuals with low technical knowledge but high goal consensus may exhibit low uncertainty in problem identification but higher uncertainty in finding solutions. Factors such as business type, strategy, external environment, and company size are considered when evaluating contingent investment decisions, which are crucial for expanding small and medium enterprises.

Modernization decisions focus on how societies undergo continuous transformation through the application of technology and intellectual means. These decisions are driven by the value expected in the future, measured in current financial terms (Hrynko & Beliavceva, 2019). A firm's modernization decisions can be assessed by comparing its performance with competitors, examining its marketing strategies, and evaluating its production and distribution capabilities.

When engaging in capital budgeting, certain objectives should be prioritized. These include selecting projects that maximize shareholder wealth, considering the opportunity cost of funds, and accounting for all cash flows (Uwah & Asuquo, 2016). Effective use of capital budgeting techniques can prevent capital project failures and minimize the abandonment of investments (Conti et al., 2019). Lower-level managers may make smaller capital investment decisions, but larger and more complex decisions are typically handled by top management, and sometimes by the board of directors, as highlighted by Tran and Turkiela (2020). Therefore, making optimal capital investment decisions is crucial for ensuring the firm’s competitiveness and achieving its long-term growth objectives (Relativo et al., 2016).

The expansion of small and medium-sized enterprises (SMEs) can be measured in several ways, including the number of employees, profits, sales turnover, and market share (Cosenz & Bivona, 2020). Profitability metrics like return on assets and equity are also used to assess growth (Mohamed, 2012). According to Muli (2013), no single measure defines development, as growth can also be evaluated using factors like market share and technological advancements (Nelly, Jagongo & George, 2019). Market share index, defined by

Mohamed (2012) as the sum of net assets, deposits, capital, and the number of loan and deposit accounts, is another indicator.

SMEs, independent businesses with a limited number of employees or financial assets, vary in definition across regions. For instance, the European Union caps SME employment at 250 employees, while the United States sets a limit of 500 employees (European Union, 2016). SME growth is closely tied to overall business success and sustainability. Mazzarol and Reboud (2020) link SME investment and expansion to factors such as the accuracy of information on opportunities, investment duration, and the financial resources required for profitability and liquidity (Graziano, 2018; Coricelli & Frigerio, 2019).

Business growth, marked by increased market share, new product offerings, and higher sales, is essential for SME survival and achieving long-term objectives (Cosenz & Bivona, 2020). Innovation, which drives entry into new markets and sales growth, is a key performance indicator (Bagheri et al., 2019). Entrepreneurs focus on profitability, innovation, and expansion (Cosenz & Bivona, 2020), with long-term business growth influenced by the owner's characteristics, planning, and responses to environmental factors (Mazzarol & Reboud, 2020). Studies show that SMEs with a focus on growth have a higher likelihood of survival than those that remain stagnant (Nelly, Jagongo & George, 2019).

The debate on whether SME growth is driven by external factors or managerial decisions remains unresolved. However, scholars agree that capital structure significantly influences business expansion. Moreover, SMEs play a vital role in economic development, particularly in developing countries, where they contribute to prosperity (Masroor & Asim, 2019). Balancing innovation with adaptability to internal and external changes is crucial for maintaining or improving performance (Nelly, Jagongo & George, 2019). Small and Medium-Sized Enterprises (SMEs) in Nairobi's Central Business District (CBD) play a crucial role in Kenya's economy, accounting for 98% of businesses, 30% of employment, and 3% of GDP, as reported by the Central Bank of Kenya (2023). However, these enterprises face numerous challenges, including inadequate capital, limited market access, poor infrastructure, lack of skills, and rapid technological changes. Despite their importance, SMEs often struggle to access financial services, which hinders their ability to improve product quality and compete effectively in the market. Microenterprises, defined under the Micro and Small Enterprises Act of 2002, employ fewer than 10 people and have an annual turnover of up to Ksh 500,000, while small and medium-sized enterprises employ 10 to 99

individuals with revenues ranging from $5,000 to $8 million. These businesses are prevalent in various sectors such as manufacturing, commerce, and services in Nairobi CBD.

The 2018 annual report by Nairobi City County highlights that most SMEs are either registered or formally managed, with about two-thirds operating officially. A significant portion of their income is allocated to investment, with small and medium-sized establishments investing 63.4% and 69.7%, respectively. However, approximately 61% of SMEs fail to survive beyond two years, often citing a lack of financial resources and market access. To support Kenya's Vision 2030, it is vital to address these challenges and foster the growth of SMEs, particularly through sound capital investment and improved access to resources, especially in urban areas like Nairobi.

### 1.2 Research Problem

In Kenya, SMEs provide employment to approximately 80% of the population. However, small businesses, especially those in Nairobi's CBD, face numerous challenges. According to the Sessional Paper No. 2 of 2005, three out of five businesses fail within their first three years, and most do not survive beyond five years. A 2017 survey by the Kenya National Bureau of Statistics revealed that around 400,000 micro, small, and medium enterprises do not make it to their second birthday. Poor growth rates are evident as early as the third month of operation. The failure of these SMEs results in job losses, increased insecurity, low liquidity in the economy, and a decline in economic growth. Poor capital investment decisions are cited as a leading cause of financial distress among SMEs in Nairobi. Capital project failures threaten the survival, growth, and contribution of SMEs to national development.

Empirical studies on capital investment have often focused on determinants and measures in developed economies, with few addressing Kenyan SMEs. Previous studies have explored topics such as investment decisions, financial management, and equity financing in sectors like technology and finance, mostly concentrating on firms listed on the Nairobi Securities Exchange. These studies have examined financial risk, bank size, and the role of equity in SME performance. However, there is limited research on how capital investment decisions—such as expansion, replacement, modernization, contingency, and diversification—specifically affect the growth of SMEs in Nairobi's CBD. This study seeks to fill that gap by exploring how these capital investment strategies influence the growth and sustainability of SMEs in this critical urban center, considering the unique dynamics that impact their success and survival.

### 1.3 Research Objectives

This study was guided by the following general objective to: investigate the effect of capital investment decisions on growth of Small and Medium Enterprises in Nairobi County CBD, Kenya.

The specific objectives were to: determine the effect of expansion investment decision on Growth of Small and Medium Enterprises in Nairobi County CBD, Kenya, establish the effect of replacement investment decision on Growth of Small and Medium Enterprises in Nairobi County CBD, Kenya, establish the effect of modernization investment decision on Growth of Small and Medium Enterprises in Nairobi County CBD, Kenya, determine the effect of contingent investment decision on Growth of Small and Medium Enterprises in Nairobi County CBD, Kenya, find out the effect of diversification investment decision on growth of small and Medium Enterprises in Nairobi County, Kenya and to establish the moderating effect of regulatory policies on the relationship between capital investment decisions and growth of Small and Medium Enterprises in Nairobi County, Kenya.

### 1.4 Research Hypotheses

This study was guided by the following null and alternative hypothesis tested at 0.05 level of significance.

**$H_{01}$**: Expansion investment decision does not have significant effect on Growth of Small and Medium Enterprises in Nairobi county CBD, Kenya.

**$H_{02}$** Replacement investment decision does not have significant effect on Growth of Small and Medium Enterprises in Nairobi county CBD, Kenya.

**$H_{03}$** Modernization investment decision does not have significant effect on Growth of Small and Medium Enterprises in Nairobi county CBD, Kenya.

**$H_{04}$** Contingent investment decision does not have significant effect on Growth of Small and Medium Enterprises in Nairobi county CBD, Kenya.

**$H_{05}$** Diversification investment decision does not have significant effect on Growth of Small and Medium Enterprises in Nairobi County, Kenya.

**$H_{06}$** Regulatory policies do not have a significant moderating effect on the relationship between capital investment decisions and growth of Small and Medium Enterprises in Nairobi County, Kenya.

## 2. Literature Review

### 2.1 Theoretical Framework

The theoretical framework guiding this study includes several key theories: the contingency theory, cash flow theory of investment, acceleration theory of investment, and discounted theory of investment. Each of these frameworks offers valuable insights into investment decision-making and the growth of small and medium-sized enterprises (SMEs), particularly in the context of Nairobi County, Kenya.

Contingency Theory of Investment: Proposed by Fred Fiedler in 1960, the contingency theory emphasizes that organizations should adapt their strategies based on the external and internal circumstances they face. This theory dismisses the idea of a one-size-fits-all approach to management, advocating for a flexible and responsive approach to investment decisions. Managers must understand the unique circumstances of their external environment to make informed investment decisions. Despite its adaptability, the theory has been criticized for its complexity and reactive nature, which can hinder proactive management. However, it provides significant advantages by helping managers develop investment skills and understand organizational principles tailored to their specific environments. Managers are encouraged to reject universal management practices and instead focus on strategies that align with their organization's particular situation. Granlund and Lukka (2017) applied this theory to explore how management accounting research impacts organizational performance. In the context of this study, the contingency theory is relevant in examining the relationship between contingency decision-making and the growth of SMEs, guiding managers in acquiring the necessary skills to make investment choices that align with their operational environment.

Cash Flow Theory of Investment: Developed by East (1993), the cash flow theory emphasizes the link between the availability of internal finance—cash flow—and investment decisions. The theory proposes three models: the liquidity model, the information theoretical model, and the managerial model. These variations, particularly the liquidity model, highlight how internal finance (mainly accumulated profits) drives investment decisions. According to the theory, a lack of internal finance can restrict investment, underscoring the importance of liquidity for seizing opportunities. Zainudin et al. (2019) emphasized that companies with a liquid balance sheet can quickly capitalize on investment opportunities when they arise. In this study, the cash flow theory will be used to analyze investment decision-making processes for SMEs

in Nairobi's central business district (CBD), focusing on how internal financing influences their growth. This theory will also guide the examination of how investment decisions impact SME growth in the region. Acceleration Theory of Investment: Proposed by Clark in 1917, the acceleration theory of investment suggests that investment is driven by expected production output. When demand increases, so does investment commitment, as businesses strive to meet this demand. This theory links investment closely with production levels, suggesting that enterprises invest more when production is expected to increase. While this theory provides insights into investment behavior, it has limitations. The rigid form of the acceleration theory assumes that firms are always in equilibrium and do not have surplus capacity, which is not always the case. Antonakis (2011) noted that the theory overlooks factors such as pricing and incentives, which can also influence investment decisions. Despite these limitations, the acceleration theory is relevant for understanding how changes in demand influence investment decisions. In this study, the theory will be applied to explore how modernizing decision-making processes, such as adopting e-commerce, can improve the performance of SMEs in Nairobi County.

The Theory of Organizational Performance: Don Elger's theory of organizational performance, introduced in 2007, emphasizes the role of leadership, management, culture, and other elements in determining the effectiveness and collaboration within an organization. Performance is viewed as an ongoing process, with each level of performance representing a new stage of effectiveness. As managers or organizations improve their performance levels, they become more adept at organizing people and resources, leading to better outcomes in shorter timeframes. This theory can be applied to the performance of SMEs, where the managers or business owners are often the primary decision-makers. The effectiveness of these individuals in organizing their resources and leading their teams can significantly impact the success of the enterprise. In the context of this study, the theory will be used to understand how performance improvement in SMEs can be linked to better investment decisions and overall business growth.

Discounted Theory of Investment: John Burr Williams (1938) introduced the discounted theory of investment, which is based on the estimation of future value by considering current financial conditions. This theory involves calculating the present value of an investment compared to its future profitability. The discounting principle is frequently used for long-term investments, as it helps determine whether the future returns of an investment justify the initial costs. This principle is especially relevant for capital-intensive projects where long-term profitability must be carefully weighed against short-term expenses. In this study,

the discounted theory of investment will be used to analyze capital investment decisions made by SMEs in Nairobi County. The theory will help determine how SMEs can assess the future profitability of their investments, taking into account factors such as costs, cash flow, and expected returns. This comprehensive analysis will provide valuable insights into how SMEs can make sound investment decisions that ensure long-term profitability.

The theoretical literature reviewed in this study offers a comprehensive foundation for understanding investment decisions and their impact on SME growth. The contingency theory provides a flexible approach to management, emphasizing the importance of adapting strategies to fit the external environment. The cash flow theory highlights the critical role of internal financing in driving investment decisions, while the acceleration theory links investment to production levels and demand. The organizational performance theory focuses on the process of improving management effectiveness, and the discounted theory of investment helps assess long-term profitability. Together, these theories offer valuable insights into how SMEs in Nairobi County can make informed investment decisions that promote growth and sustainability. Capital investment decisions are vital for the long-term success of firms and should be meticulously planned. These decisions often involve multiple stakeholders and are more complex due to their lasting impact on a company's future. Numerous studies have classified capital investment decisions into different categories, but for this review, we will focus on expansion, replacement, modernization, contingency, and diversification decisions, which are key to understanding the growth of small and medium-sized enterprises (SMEs).

## 2.2 Empirical Review

### 2.2.1 Expansion Decision and Growth of SMEs

Expansion decisions are critical revenue choices that can significantly affect the growth and development of organizations. Research by Samson, Gardebroek, and Jongeneel (2016) found that expansion decisions in Dutch dairy enterprises had a direct impact on firm performance, often leading to larger operations rather than maintaining the status quo. Growth decisions typically carry more uncertainty than replacement decisions and require careful consideration. Many companies aim to expand into new markets, either locally or internationally, as part of their long-term objectives. Al-Mutairi and Burns (2015) emphasized that advancements in communication, transportation, technology, and international treaties have made it easier

for companies to realize global growth. However, these efforts often fail when firms do not thoroughly understand the internal and external factors influencing their market choices.

Musau (2016) explored the effects of expansion decisions on the performance of large enterprises, finding that SMEs are particularly motivated by the potential for economies of scale, which is a common goal across organizations. The expansion of a business is often viewed as a sign of growth, which aligns with the objective of wealth maximization. However, with expansion comes increased risks, such as exposure to new competition, higher costs, and investments in assets. Musau concluded that while expansion could lead to success, it also introduces new challenges that businesses must navigate. Similarly, Roger (2010) examined the importance of asset allocation in driving business expansion. The study showed that the primary goal of growth is to increase customer coverage, improve financial surpluses, and decrease deficits, all of which contribute to overall firm growth. A study by Richard, Jonathan, and Sharon (2014) using a panel regression model found that the business environment of a country plays a significant role in influencing the likelihood of international franchise expansion. The research suggested that understanding the dynamics of the external environment is crucial for successful international growth. However, the study lacked a theoretical foundation, which subsequent research could address.

### 2.2.2 Resolving Replacement Decisions and Fostering SME Growth

Replacement decisions are often made to improve efficiency and foster business growth. Abdi and Taghipour (2019) developed a repair-replacement choice model that considered environmental impacts, maintenance quality, and associated risks. Their model showed that replacement decisions, particularly in capital budgeting, are relatively straightforward, especially when the cost is low, and the consequences of not investing are high for production, operations, or sales. Shilon (2018) added that decisions involving replacing old equipment with newer, more efficient models are generally straightforward, providing confidence in positive outcomes.

Ewens and Marx (2018) explored how venture capitalists (VCs) boost the performance of portfolio companies by replacing founders. Their research demonstrated that founder replacement can lead to improved company performance, particularly when factors like equipment reliability, maintenance quality, and corrective maintenance frequency are taken into account. Using data from Thai investors in the hospitality industry, Sungkhamanee and colleagues (2021) investigated how psychological factors such as

salience and overconfidence influence long-term investment decisions. They found that overconfidence and salience significantly impact these decisions, with financial literacy acting as a major moderator. The study suggested that investors must assess these traits carefully to avoid financial losses in long-term investments.

James (2015) conducted a study in the insurance industry, examining the financial effects of system replacements. The findings revealed that system changes did not significantly impact revenue growth or operational efficiency. Similarly, Pieper, Nüesch, and Franck (2014) used betting odds in professional soccer to analyze the effect of performance expectations on managerial replacement decisions. Their research found that higher performance expectations increase the likelihood of management changes, particularly in professional sports.

### 2.2.3 Decisions on Modernization and the Growth of SMEs

Modernization decisions are crucial for businesses seeking to increase efficiency and productivity, both of which contribute to long-term growth. Symakov (2020) focused on management decisions regarding the modernization of e-commerce firms in Russia. His study highlighted the importance of creative entrepreneurship and how global experiences shape the need for technological solutions and modern management approaches in e-commerce businesses. The research emphasized that modernization is necessary to stay competitive in today's fast-paced digital economy, especially for firms operating in industries like e-commerce.

Yiming, Siqi, Thomas, and Thomas (2011) conducted a multivariate regression analysis to determine whether banks consider the financial performance of borrowers when deciding on loan renewals or interest rate adjustments. Their research found that modernization strategies often emerge when firms experience declining performance, and they are seen as a way to recover from financial challenges. However, the study also revealed that firms with poor financial performance are less likely to receive favorable loan renewal terms from lenders, highlighting the importance of maintaining a strong financial position during modernization efforts.

Jeffrey and Jeffrey (2012) examined the role of lease renewal options in the context of capital investment, finding that firms with lease renewal options are often viewed less favorably by lenders. Martin, Christopher, and Steven (2013) found that performance feedback plays a critical role in influencing strategic

renewal efforts related to modernization decisions. Their research showed that firms are more likely to pursue modernization strategies when they receive negative performance feedback, underscoring the importance of continual organizational learning and adaptation.

### 2.2.4 Decisions on Emergencies and the Development of Small and Medium-Sized Enterprises

Contingency planning is essential for small and medium-sized enterprises (SMEs) as it involves supplementary tasks that enhance primary operations. Research by Cobb, Wry, and Zhao (2016) highlighted the role of institutional logics and contextual contingencies in microfinance funding, concluding that microfinance can effectively address extreme poverty globally. The study, which analyzed a proprietary database of loans from 2004 to 2012, indicated that the relationship between institutional logics and organizational practices is context-dependent. This finding broadens the understanding of microfinance's role in poverty alleviation and emphasizes the importance of contextual factors in lending practices.

In a separate study, Gupta and Batra (2019) examined the relationship between entrepreneurial orientation (EO) and firm performance among SMEs in India. Their findings revealed a strong positive correlation between EO and company success, positing that this relationship could be influenced by environmental contingencies and competitive severity. This research not only provides insights into the conditions that enhance entrepreneurial tactics but also suggests avenues for further inquiry into the dynamics between EO and performance.

Titus, Parker, and Covin (2019) further explored how an organization's objectives influence its willingness to engage in risky external ventures, particularly focusing on equity-based corporate venturing. Their research indicated that a company's EO significantly affects how employees respond to variations in performance feedback, establishing EO as a critical factor in organizational adaptability. A comprehensive literature review by Hamann (2017) on business planning within the framework of contingency theory examined 195 articles published from 1967 to 2017. The review identified key contextual elements that influence organizational planning, including management philosophy, organizational size, environmental uncertainty, and task interdependence. By collating consistent outcomes across various contexts, Hamann argued for a robust contingency theory of corporate planning, providing a foundation for understanding how different factors interact within organizational settings.

Kiss and Barr (2017) investigated the timing of new product development strategies and their impact on the success of new ventures. Their study suggested that longer implementation periods for new product strategies could benefit companies led by teams with centralized mental models, particularly in stable industries. Conversely, in dynamic and unpredictable sectors, extended timelines may not yield additional benefits. Their findings emphasized the influence of industry growth rates and team dynamics on the effectiveness of new product development strategies.

Adomako, Opoku, and Frimpong (2018) assessed how improvisational behavior among entrepreneurs correlates with the success of new ventures, considering the moderating effects of financial resources and institutional support. Their research, involving 395 new enterprises in Ghana, found that access to financial resources significantly affects the relationship between improvisation and venture success. Additionally, the degree of institutional support was shown to impact the effectiveness of entrepreneurial improvisation in driving business growth.

Manolopoulos, Chatzopoulou, and Kottaridi (2018) examined the connection between resources, the domestic institutional framework, and the exporting capabilities of SMEs in Greece. Their study revealed that both formal and informal institutional factors significantly influence export activities among SMEs. Additionally, the entrepreneurs' perceptions of their domestic institutional environment play a crucial role in resource allocation decisions related to exporting, indicating that weaknesses in the institutional landscape may lead SMEs to redirect resources toward export sales.

The concept of diversification as a growth strategy for SMEs was explored by Bachtiar (2020), who used the growth stage model to assess when SMEs might benefit from diversification. The findings suggested that SMEs in Indonesia could gain more from diversification compared to larger companies, with the growth stage being a critical determinant. The study emphasized that while diversification is possible, it should not be attempted in the early stages of business development. By employing a TOWS analysis, the research highlighted the significance of understanding diversification choices within SMEs.

Chen and Paik (2021) investigated the impact of subnational institutions on SMEs' diversification efforts in China. Their analysis of 3,240 SMEs indicated that the presence of state-owned enterprises (SOEs) and the development of local market systems influence diversification decisions. The findings revealed that

SMEs in regions dominated by SOEs are less likely to diversify, as market systems evolve to favor local market services over unrelated industries. In Austria, Situm (2019) conducted a study examining the effects of diversification on SMEs' performance using a resource-based view. The research, which spanned three years and analyzed 1,095 SMEs, found inconclusive results regarding the profitability associated with related versus unrelated diversification. It highlighted that while related diversification might decrease risk for medium-sized firms, the resource-based view alone cannot fully predict the impact of diversification strategies on profitability.

Benito-Osorio et al. (2020) studied the joint effect of regional and product diversity on manufacturing SMEs' performance. Their analysis, based on dynamic panel data from 1994 to 2014, uncovered a horizontal S-shaped relationship between spatial diversity and performance. The results indicated that while geographically diversified SMEs could benefit from related product diversification, those with low or high levels of international diversification faced challenges when pursuing unrelated product strategies.

The role of regulators in shaping SME growth is crucial, as highlighted by Oladele et al. (2019), who investigated how regulatory policies affect SMEs' capital investment decisions. Their survey of 500 SMEs in Nigeria revealed a negative correlation between regulatory measures and SMEs' growth, emphasizing the detrimental effects of taxes, licenses, and permits on capital project investments. Further exploring non-financial factors influencing capital budgeting techniques among SMEs, Alles et al. (2021) conducted a mixed-method study in Sri Lanka. Their findings indicated that the Payback Period (PBP) was the most widely adopted capital budgeting approach, with SMEs in specific circumstances—such as those with longer operational histories or international exposure—more likely to use the Net Present Value (NPV) method. The qualitative component of the study identified knowledge, cost, and effort as barriers to implementing capital budgeting techniques.

Bwambale et al. (2020) assessed the impact of regulatory policies on the capital investment decisions and growth of Ugandan SMEs, finding that regulatory regulations adversely affect these enterprises. Their study revealed that tax laws and licensing requirements hinder SMEs' ability to invest in capital projects, ultimately stifling their growth potential. Similar findings were echoed in research by Mutua (2019), which emphasized the need for the Kenyan government to reevaluate regulatory policies affecting SMEs' capital investment and growth. Lastly, Ndirangu and Ochieng (2018) investigated the effects of regulatory policies

on the capital investment and growth of SMEs in Tanzania. Their mixed-method research corroborated the findings of other studies, concluding that government policies—specifically tax laws, licensing requirements, and labor restrictions—significantly impact the capital investment decisions and growth trajectories of SMEs in Tanzania.

## 3. Research Methodology

The research philosophy adopted in this study is rooted in positivism, which emphasizes objectivity and the existence of an independent reality, as highlighted by Urquhart (2008). Positivism asserts that truth and reality are separate from the researcher, who must remain impartial to uncover this objective truth. According to positivists, the universe operates under immutable principles and laws of causality, as Griffin (2006) suggests, and researchers often use a reductionist approach to navigate complexity. Positivists believe the world exists as an objective material reality, not influenced by subjective mental processes (Venkatesh, 2006). This approach enabled the researcher to impartially examine the correlation between SME growth and capital investment decisions in Nairobi City County, Kenya.

In terms of research design, Yin (2017) describes it as a plan for data collection aimed at balancing relevance and study objectives. A descriptive research strategy was used in this study, which helps in discovering relationships between variables without manipulating them. Curtis, Comiskey, and Dempsey (2016) emphasize that this method gathers unbiased data without influencing the respondents or study variables. Similar descriptive approaches were employed in previous studies on SMEs. For instance, Mwangi (2021) explored the influence of microfinance on SMEs' growth, Kamau (2020) investigated the impact of marketing strategies on SME productivity, and Singh and Gaur (2018) examined how financial literacy affected business growth. Likewise, Kumar and Kumar (2019) studied the effect of technology adoption on SME performance in Malaysia using a descriptive approach.

The target population for this study consists of small and medium-sized enterprises (SMEs), with a focus on owner-managers as the unit of observation. Singleton and Straits (2010) define the target population as the total number of respondents who meet specific criteria, while Ngechu (2004) describes it as the group the researcher aims to generalize findings to. In this case, the study targeted 1,367 SMEs registered in Nairobi’s Central Business District (CBD) between 2013 and 2022.

**Table 1.1 Target Population**

| Sector | Small Enterprises | Medium Enterprises | Total | Percent (%) |
|---|---|---|---|---|
| General Traders shops and Retail Services | 223 | 194 | 417 | 31 |
| Transport Storage and Communications | 67 | 41 | 108 | 8 |
| Accommodation and Catering | 224 | 98 | 322 | 24 |
| Technical and Financial services | 92 | 54 | 146 | 11 |
| Private Education, Health and Entertainment | 72 | 50 | 122 | 9 |
| Industrial Plants, Factories, Workshop, Contractors | 46 | 20 | 66 | 5 |
| Small Trades Services | 103 | 83 | 186 | 14 |
| **Total** | **827** | **540** | **1,367** | **100** |

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### 3.1 Data Analysis and Findings

The study used a combination of stratified and simple random sampling to ensure comprehensive population coverage. Strata were based on various economic sectors, with firms selected proportionally. Stratified sampling divides the population into homogeneous groups, offering equal chances for selection and minimizing sampling error. This method, as per Ndede (2015) and Trochim (2000), ensures all population layers are included, providing accurate representation. The approach was adopted to improve reliability and reduce errors, as highlighted by Mugenda and Mugenda (2008).

The study employed questionnaires as the primary data collection tool, targeting owners or managers of SMEs in Nairobi City County, Kenya, to examine the impact of capital investment choices on their development. The use of questionnaires is justified by their efficiency in gathering data from numerous

respondents quickly and at a low cost. As stated by Gillham (2008), questionnaires allow for the rapid and inexpensive collection of information, and Saunders, Lewis, and Thornhill (2009) emphasize that standardized questionnaires minimize interviewer bias, ensuring consistency in data collection. Additionally, questionnaires can be distributed to a wide range of respondents, including those in different locations, making them ideal for SMEs in Nairobi City County (Bryman & Bell, 2015). Respondents can complete the questionnaires at their convenience, which can result in a higher response rate (Dillman, Smyth, & Christian, 2014). Structured, closed-ended questions, particularly on a 5-point Likert scale ranging from strongly disagree to strongly agree, facilitate statistical analysis and help in identifying patterns and correlations (Kothari, 2004). However, questionnaires have limitations, such as restricting respondents' ability to express themselves fully and requiring careful reading before responding (Kothari, 2008).

A pilot study was conducted to identify potential shortcomings in the questionnaire and sampling methods, testing 14 questionnaires as per Gall and Borg's (2006) recommendation that 9–10% of the sample population should participate in pilot testing. The study also included validity and reliability tests. The validity test ensured the questionnaire's ability to measure the intended variables accurately, supported by expert review (Bryman & Bell, 2013). The reliability test, using Cronbach's Alpha to assess internal consistency, indicated a reliability score of 0.7, which is deemed acceptable according to Bryman and Bell (2013). This pilot test provided valuable feedback, which was incorporated into the final version of the questionnaire.

The data collection approach involved identifying the target businesses, informing participants about the study's purpose, and distributing questionnaires to SME owners and managers using a drop-and-pick method. The respondents were given an agreed-upon time to complete the survey, after which the researcher collected the questionnaires, ensuring a high response rate. For data analysis, SPSS version 22.0 was used for coding. Descriptive statistics like frequencies, percentages, means, and standard deviations were employed, with data presented in tables and figures. Pearson's correlation analysis was conducted to assess the relationships between variables. A multiple regression model was applied to examine the impact of capital investment decisions on the growth of SMEs in Nairobi County CBD, with variables such as expansion, replacement, modernization, contingency, diversification decisions, and regulatory policies.

The model was: $Y= \beta 0 + \beta 1ED + \beta 2RD + \beta 3MD + \beta 4CD + \beta 5DD + \beta 6MV + \varepsilon$, where Y represents SME growth. The composite growth index and average return on assets were calculated using average total assets

and net income. Statistical significance was tested using parametric tests, including the F-test and t-tests in ANOVA. Operationalization was discussed as the process of defining and measuring variables, with concepts identified and linked to real-world phenomena.

$Y= \beta_0+ \beta_1ED+\beta_2RD+ \beta_3MD+ \beta_4CD++ \beta_5DD+ \beta_6MV+ \varepsilon$

Where:

Y = Growth of SMEs,

ED= expansion decision;

RD= replacement decision;

MD= modernization decision;

CD= Contingency decision;

DD= Diversification Decision;

## 4. Results and Discussion

### 4.1 Response Rate

The researcher administered 310 questionnaires, receiving 80% (n=248) complete responses and excluding 20% (n=62) incomplete ones from the analysis. Figure 1.1 illustrates the categorization of returned questionnaires.

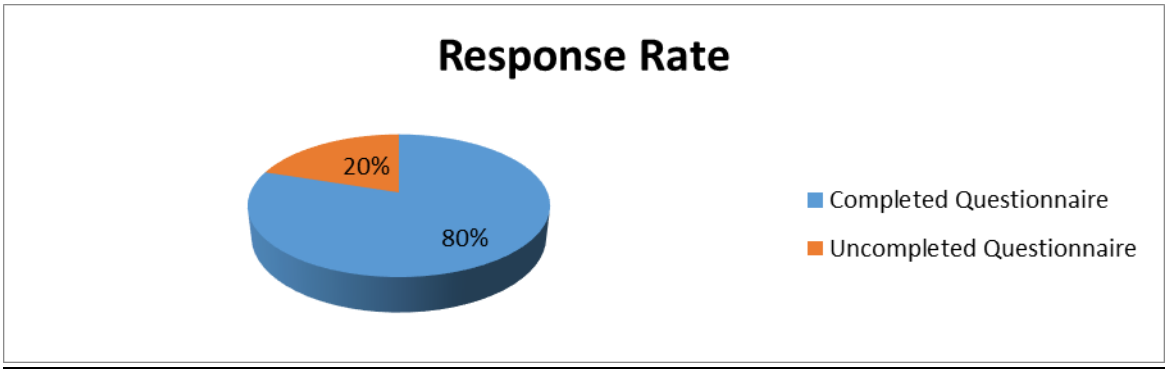


**Figure 1.1 Response Rate**

### 4.2 Demographic Characteristics

The demographic data of respondents was crucial for ensuring a representative sample and the generalizability of the study's findings. The study considered respondents' gender, designation, age category, and firm location. The gender distribution was relatively balanced, with 54.8% female and 45.2% male, ensuring no bias towards a specific gender. The largest age group was 31-40 years (45.2%), followed by 41-50 years (33.3%), providing a fair demographic representation. Respondents' work experience was notable, with 33.3% having 15-20 years of experience and 29.3% having 11-15 years, enhancing the credibility of the findings by incorporating insights from seasoned professionals. In terms of education, 49.6% of respondents had college education, and 47.2% had university education, minimizing sampling bias and supporting the generalizability of results to venture capital practitioners. The study utilized both quantitative and qualitative methods, drawing from primary and secondary data provided by financial experts, particularly managers and SME owners. Their extensive experience ensured the results accurately reflected the actual conditions in the field, further validating the study's overall findings.

**Table 1.2 Demographic Characteristics**

| Category | Sub-Category | Frequency | Percent |
|---|---|---|---|
| Gender | Male | 112 | 45.2 |
| | Female | 136 | 54.8 |
| | **Total** | **248** | **100.0** |
| Age Bracket | 21-30 years | 34 | 13.7 |
| | 31-40 years | 112 | 45.1 |
| | 41-50 years | 83 | 33.3 |
| | Over 51 years | 19 | 7.8 |
| | **Total** | **248** | **100.0** |
| Working Experience | 5-10 years | 24 | 9.7 |
| | 11-15 years | 73 | 29.3 |
| | 15-20 years | 117 | 33.3 |
| | Over 20 years | 34 | 13.7 |
| | **Total** | **248** | **100.0** |
| Level of Education | O Level | 8 | 3.2 |
| | College | 123 | 49.6 |

| | | |
|---|---|---|
| University | 117 | 47.2 |
| **Total** | **248** | **100.0** |

### 4.3 Descriptive Statistics

The study undertook a quantitative approach to analyze investment decisions among Small and Medium Enterprises (SMEs) in Nairobi City County, Kenya, focusing on several types of investment decisions. The analysis sought to understand respondents' views and opinions to explain the results of inferential statistics in investment decision-making. The descriptive analysis covered expansion, replacement, modernization, contingent, and diversification investment decisions.

The first focus, expansion investment decisions, revealed a consistent opinion among respondents, as indicated by the aggregate mean of 3.5782 and a low standard deviation of 0.6108. The study found that SMEs moderately achieve expansion through strategic business approaches, maximizing profit from short life-cycle products or services, taking advantage of business opportunities, and gaining economies of scale. However, expanding into new markets involves risks such as competition and asset investment. Prior research supports the importance of expansion in business growth, emphasizing economies of scale and customer coverage. The findings suggest that businesses should focus on strategic planning, market research, and risk management to navigate challenges and optimize growth opportunities. The study highlights the need for innovation, unique product offerings, and long-term planning in expansion strategies, providing valuable insights for policymakers to support SME growth.

The second section on replacement investment decisions showed strong agreement among respondents, with the highest mean of 4.5847 related to depreciation expenses when equipment breaks down. Businesses were found to prioritize replacing inefficient equipment to maintain operational efficiency, though there was less certainty about setting aside costs for sustainability. The study suggests that replacement decisions are generally straightforward, particularly when inefficiencies or breakdowns threaten production. This aligns with existing research indicating that such decisions are simpler when operational impacts are clear. However, contrasting studies suggest that psychological and financial factors can influence replacement decisions, with varying outcomes across different industries. The findings have important implications for SME managers, emphasizing the need for careful consideration of financial and operational impacts when making replacement decisions. Effective strategies to ensure sustainability and minimize costs are crucial,

especially in managing equipment failures. The study recommends further research into the factors influencing investment decisions across various sectors to deepen understanding and improve decision-making processes.

The findings on contingency decisions, diversification, regulatory policies, and growth of SMEs in Nairobi City County highlight the importance of strategic decision-making in fostering SME growth. The study reveals that contingency decisions play a critical role in business operations, with SMEs relying on established rules, routines, and performance programs to guide decisions such as hiring and budgeting. These decisions enable product diversification and crisis management, with an overall moderate consensus among respondents about the importance of contingency planning for innovation and competitive positioning.

Diversification strategies are also essential for SME growth, with SMEs moderately engaging in concentric and horizontal diversification. The findings suggest that diversification can increase sales, revenue, and profit margins, although success depends on market conditions and the type of diversification pursued. Regulatory policies significantly influence SMEs' investment decisions, particularly in capital projects. Transparent and effective government policies are seen as crucial for business growth, helping to streamline bureaucracy and reduce the cost of doing business. The study also finds that SMEs in Nairobi City County have made moderate progress in market penetration, operational improvements, and maintaining a high-quality team. Respondents believe that efficiency and effectiveness in service provision, alongside maintaining organizational culture and values, are key to sustaining long-term growth. These findings align with previous research emphasizing the role of process optimization, team quality, and market penetration in enhancing SME performance. Overall, the empirical evidence suggests that strategic contingency planning, diversification, effective regulatory policies, and a focus on operational improvements are vital for the growth and competitiveness of SMEs in Nairobi City County.

### 4.4 Regression Analysis

Regression analysis is an inferential statistics technique that estimates the effects of individual predictor variables on an outcome variable through regression coefficients (β). Positive beta coefficients indicate a direct relationship, while negative values signify an inverse relationship. T-tests are employed to conduct hypothesis tests on these coefficients in simple linear regression, with p-values determining the presence of

relationships in the larger population. Each independent variable's p-value tests the null hypothesis of no correlation with the dependent variable. A p-value below the significance level indicates enough evidence to reject the null hypothesis, suggesting that changes in the independent variable correlate with changes in the dependent variable at the population level. This statistical significance implies the variable should be included in the regression model. Conversely, if the p-value exceeds the significance threshold, it suggests insufficient evidence to confirm a non-zero correlation, leading to the variable's exclusion from the regression model.

**Table 1.3: Coefficients[a]**

| Model | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | 7.080 | 1.882 | | 3.762 | .000 |
| Expansion Decision | 1.260 | .142 | .309 | 8.896 | .000 |
| Replacement Decision | 1.993 | .137 | .407 | 14.584 | .000 |
| Modernization Decisions | .839 | .073 | .324 | 11.537 | .000 |
| Contingency Decision | 1.093 | .053 | .593 | 20.447 | .000 |
| Diversification Decisions | .115 | .086 | .055 | 1.335 | .183 |

a. Dependent Variable: Growth of SMEs

### 4.5 Model Summary

The coefficient of determination ($R^2$) is a key measure in regression analysis that indicates the proportion of variance in the dependent variable explained by the independent variable(s). $R^2$ ranges from 0 to 1, where 0 means the dependent variable cannot be predicted by the independent variable, and 1 means it can be predicted without error. An $R^2$ value between 0 and 1 shows the extent of predictability. In this study, an $R^2$ value of 0.857 was found, meaning that 85.7% of the variation in SME growth can be explained by the independent variables—expansion, replacement, modernization, contingency, and diversification decisions. The remaining 14.3% of growth is influenced by other factors. The correlation coefficient (R) of

0.927 indicates a very strong relationship between the independent and dependent variables. Using multiple regression analysis, a correlation coefficient greater than 0.90 is considered very strong, suggesting that these decision-making factors have a significant influence on the growth of SMEs. According to Moore, Notz & Flinger (2013), an $R^2$ value of 0.30 is acceptable, further reinforcing the relevance of the findings in this study.

**Table 1.4: Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .927[a] | .860 | .857 | 1.65778 |

a. Predictors: (Constant), Expansion Decision, Replacement Decision, Modernization Decisions, Contingency Decision, Diversification Decisions

**4.6 ANOVA**

The analysis of variance (ANOVA) results show that the model used in the study is significantly better at predicting the outcome variable compared to using the mean. Table 1.5 indicates that the calculated F-value is greater than the critical F-value, with a p-value of 0.00, confirming the model's significance at a 95% confidence level. As a result, sub-hypotheses $H_{01}$ to $H_{06}$ are rejected. The regression model is a good fit for the data, suggesting a true relationship exists, making it suitable for assessing the impact of investment decisions on SME growth in Nairobi City County.

**Table 1.5: ANOVA[a]**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 4076.066 | 6 | 679.344 | 247.194 | .000[b] |
| | Residual | 662.321 | 241 | 2.748 | | |
| | Total | 4738.387 | 247 | | | |

a. Dependent Variable: Growth of SMEs

b. Predictors: (Constant), Expansion Decision, Replacement Decision, Modernization Decisions, Contingency Decision, Diversification Decisions

## 5. Conclusions

The study's findings lead to several key conclusions regarding investment decisions and their impact on the growth of Small and Medium Enterprises (SMEs) in Nairobi County's Central Business District. First, it was established that expansion investment decisions significantly influence SME growth, with strategic business planning, market opportunity capitalization, and company size facilitating moderate expansion and risk mitigation. This emphasizes the necessity of strategic expansion for sustainable growth. Second, the study found that replacement investment decisions also significantly affect growth, as SMEs favored upgrading to more efficient equipment to enhance operational efficiency and reduce costs, highlighting the importance of maintaining competitiveness. Third, modernization investment decisions emerged as critical, enabling SMEs to adopt new marketing strategies and proprietary technologies that enhance production and distribution capabilities, thereby boosting competitiveness and growth potential. Fourth, contingent investment decisions were shown to significantly affect SME growth, with businesses utilizing established rules and performance programs to diversify their offerings and effectively respond to crises, underscoring the importance of contingency planning. Conversely, diversification investment decisions were found to have an insignificant effect on growth, despite SMEs reporting higher margins and revenue from diversification efforts; this indicates that while diversification can be beneficial, it is not prioritized by all SMEs. Lastly, the study concluded that regulatory policies do not significantly moderate the relationship between investment decisions and SME growth, suggesting that while a positive correlation exists, it lacks statistical significance. This points to the necessity for further research and potential reforms aimed at improving the regulatory environment for SMEs to enhance their growth potential.

## 6. Recommendations

The study offers several recommendations based on its findings, focusing on policy implications, practical applications, and avenues for future research. Firstly, regarding policy, it suggests that the Kenyan government should establish a comprehensive regulatory framework to tackle the investment exit challenges prevalent in venture capital financing. Many entrepreneurs start their businesses intending to retain ownership and management as they expand; however, the lack of a clear exit strategy often undermines this goal, hindering the growth of small and medium enterprises (SMEs). The study

recommends that an explicit exit route plan should be submitted to a relevant regulatory authority to facilitate smoother transitions for entrepreneurs.

On the practical side, the study emphasizes the need for SMEs to implement management boards that can provide professional advice. By drawing on the diverse experiences of a professional board of directors, management employees can enhance their skills and contribute to the growth of their businesses. Additionally, the study urges SMEs to develop working capital management policies to address the low growth rates typically observed in this sector. Entrepreneurs must also confront issues of information asymmetry, such as adverse selection and moral hazard, which can negatively affect their operations. By improving their understanding of these challenges, SME owners can better manage expectations and conflicts of interest. The study encourages start-up owners to take advantage of capacity-building opportunities offered by venture capitalists, which can enhance their managerial skills and technical capabilities in a competitive global market.

Lastly, the study acknowledges limitations related to its primary data collection methods, including potential reluctance from respondents to share sensitive financial information, which may have compromised data accuracy. The study suggests that future research could benefit from employing secondary data collection methods, such as financial statements and industry analyses, to provide more comprehensive insights into capital investment decisions and their impact on SME growth. It also recommends a longitudinal approach to capture changes over time and to consider a broader geographical scope beyond Nairobi City County. Qualitative methods, including in-depth interviews and case studies, could further enrich the findings by providing context-specific insights. Finally, future studies should examine how external factors, such as economic conditions and government policies, may influence the relationship between capital investment decisions and SME growth, ultimately contributing to a deeper understanding of the dynamics driving SME development.

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