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Financial Forecasting and Profitability of the Top 100 SMEs in Kenya

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Abstract

Small and Medium Enterprises constitute critical economic drivers in developing economies, yet their profitability remains volatile despite contributing approximately 24% to Kenya's GDP and employing over 93% of the active labor force. This study examined the effect of financial forecasting on the profitability of the Top 100 SMEs in Kenya. An explanatory research design under positivist philosophy was adopted, employing a census approach that selected 40 consistently listed firms from the Top 100 SMEs ranking. Data were collected through questionnaires for primary information and audited financial statements for secondary data, then analyzed using SPSS with linear regression analysis. The results showed that financial forecasting had a statistically significant positive effect on profitability ($\beta = 2.10$, $p = 0.027$), meaning a one-unit improvement in forecasting increased profitability by 2.10 units. With $R = 0.36$ and $R^2 = 0.13$, the model indicated a moderate relationship where forecasting explained 13% of profitability variation, leading to the rejection of the null hypothesis at the 0.05 level. The study concludes that financial forecasting serves as a statistically significant determinant of profitability among Kenya's Top 100 SMEs, with effective forecasting enabling enterprises to predict cash flow fluctuations, manage liquidity prudently, and identify profit-enhancing opportunities. The study recommends that the Kenya MSME Authority should develop standardized financial forecasting training programs targeting SME managers to enhance predictive accuracy and implementation, the Kenya Association of Manufacturers should establish forecasting benchmarking frameworks enabling SMEs to compare practices against industry standards, financial institutions should integrate forecasting capability assessments into credit evaluation processes while providing technical support to borrowers and policymakers should mandate periodic forecast reviews and documentation for SMEs seeking government support programs to institutionalize strategic financial planning practices that demonstrably improve profitability outcomes.

Keywords: *Financial Forecasting, Profitability, Top 100 SMEs, Kenya*

1.0 Background of the Study

Small and Medium Enterprises (SMEs) serve as key economic drivers in developing economies, fostering innovation, job creation, and industrial diversification. In Kenya, SMEs contribute approximately 24% to Gross Domestic Product (GDP) and employ more than 93% of the active labor force (Kenya MSME Authority, 2022). Their profitability, however, has experienced significant volatility over recent years, prompting renewed attention to internal management practices, particularly financial forecasting, which determines their ability to anticipate, plan, and adapt to shifting market conditions (Mutegi, 2016; Zahoor, Khan, Meyer & Laker, 2023). The Top 100 SMEs, identified annually through a joint initiative by KPMG and Nation Media Group, represent Kenya's most resilient enterprises, yet many still report fluctuating profit margins due to poor forecasting accuracy and limited strategic financial planning (KPMG & NMG, 2023). The persistent decline in profitability across segments underscores the strategic importance of enhancing financial forecasting capacities to sustain enterprise performance and competitiveness.

The SME Profitability Index published by the Kenya National Bureau of Statistics (2022) revealed that between 2018 and 2023, average net profit margins among SMEs fell from 10% to below 6%, largely due to macroeconomic shocks such as COVID-19 disruptions, currency depreciation, and rising input costs. This decline exposed the vulnerability of SMEs to external shocks and highlighted internal deficiencies in financial planning and projection accuracy. Poor forecasting results in misaligned budgets, inadequate working capital, and inefficient resource allocation, which cumulatively erode profitability (Ye & Kulathunga, 2019). Conversely, firms that maintain robust forecasting systems can predict cash flow fluctuations, manage liquidity prudently, and identify profit-enhancing opportunities ahead of time (Eniola & Entebang, 2016). Therefore, effective financial forecasting functions as a protective mechanism against market uncertainty and as a strategic driver of profit growth.

Globally, forecasting practices have been recognized as central to business resilience. The Organisation for Economic Co-operation and Development (OECD, 2021) reported that SMEs with structured forecasting mechanisms in countries such as South Korea, Singapore, and Germany demonstrated 35–50% higher profitability growth compared to those relying on reactive financial planning. In the United Kingdom, Didonet, Fearne, and Simmons (2020) found that SMEs that integrated short- and long-term forecasting techniques exhibited stronger liquidity control and superior cost efficiency. Similarly, Chen, Diaz, Sensini, and Vazquez (2020) confirmed that forecasting accuracy correlates positively with profitability in Chinese manufacturing SMEs, where forecasting served as a tool for aligning production with market demand. These global findings reinforce that the absence of predictive financial mechanisms is a root cause of performance inconsistencies in emerging markets such as Kenya.

Within the African context, the lack of data-driven forecasting frameworks has been cited as a principal constraint on SME growth (UNCTAD, 2021). Many firms operate without systematic methods for estimating revenues, expenses, or capital requirements, making them reactive rather than proactive in financial decision-making (Gamage et al., 2020). This shortfall weakens profit planning and heightens the likelihood of liquidity crises. In Ghana, Alhassan (2020) demonstrated that SMEs possessing financial forecasting skills achieved superior returns on assets, while Yakob

and Rusli (2021) observed that forecasting competency enabled Malaysian SMEs to better anticipate economic shifts and maintain stable profit margins. Such evidence situates financial forecasting as a universal determinant of profitability, regardless of national context or industry.

Kenyan SMEs encounter compounded challenges due to information asymmetry, inflation volatility, and constrained access to credit (Central Bank of Kenya, 2022). Many SME owners rely on intuition or historical trends to make financial projections, often without formal forecasting tools, resulting in over- or under-estimation of future cash flows and profitability (Chepngetich, 2016). A 2023 Kenya Association of Manufacturers (KAM) survey established that 61% of SME respondents lacked documented financial forecasts, while 74% had never revised revenue projections after-market shifts. This gap in predictive capability undermines strategic decision-making and restricts profitability growth potential. The situation is particularly critical for the Top 100 SMEs, where growth momentum requires precise planning, yet forecasting remains inconsistent and largely informal.

Empirical studies consistently show that financial forecasting enhances SME profitability by improving operational efficiency, guiding investment decisions, and supporting better working-capital management, with evidence from Mutegi (2016), Gaio and Henriques (2018), and Sitharam and Hoque (2016) demonstrating stronger sales growth, higher returns, and reduced operational losses among firms that forecast effectively. This relationship is grounded in financial literacy theory, which views forecasting as a strategic decision-making tool rather than a routine bookkeeping activity, enabling entrepreneurs to align business activities with profit targets. Despite this, limited localized research exists in Kenya, where volatile markets and weak financial literacy hinder accurate forecasting. The present study therefore focused on the Top 100 SMEs to assess how forecasting knowledge, processes, and accuracy affect profitability, offering evidence to strengthen SME policy, managerial capacity, and long-term performance in Kenya.

1.1 Statement of the Problem

Interest in SMEs studies shows a progressive upward trend throughout the third world countries due to the contribution they make to their economies. The World Bank (2020) technical report on SMEs clearly indicates that 90% of businesses around the world are SMEs and they also account for about 60 to 70% of employment and almost 50% of global GDP. Small and Medium enterprises however remain with a myriad of issues, most of which are linked to their profitability and stem from a lack of finance, investment capital, and financial support services. As noted by Lusimbo (2016), SMEs are unable to have sustainable profits often due to low levels of financial capability and poor management skills. Moreover, financial constraints usually limit access to essential credit, resulting in imbalanced resources that threaten the sustainability of the organization. An analysis by Chepkemoi et al. (2017) explains that the lack of profitable financial management strategies from SME leaders reduced their ability to operate competitively in the market and to remain in business. From 2018 to 2023, profitability for SMEs in Kenya has seen a downward trend. In 2018, only 15% of SMEs were making profits above the 20% mark, with others making profits lower than this. There were also considerable drops in profit with COVID-19; 50% of SMEs in Kenya had losses (Kenya National Bureau of Statistics, 2022).

The downward trend in SME profitability from 2018 to 2023 has been linked to poor financial literacy. Many businesses did not account for financial forecasting, making it difficult to anticipate changes in the market, cash flow management, and circumstances in times of crisis (KNBS, 2022). Understanding financial concepts is crucial to the formulation of strategies essential for financial risk management. Without such strategies, SMEs will continue to face supply chain disruption and market volatility, leading to liquidity challenges (Central Bank of Kenya, 2022). Financial literacy is crucial to develop resilience in SMEs (Kenya Association of Manufacturers, 2022). While SMEs contribute to economic growth, there are many threats to their profitability, which manifest in different contexts. Many scholars have researched this topic; however, research draws conclusions from heterogeneous socio-economic, regulatory, and cultural contexts resulting in limited applicability to Kenyan SMEs.

Existing research on SMEs is anchored on cross-sectional designs that provide a mere snapshot of SME performance at any given time without involving long-term trends; longitudinal studies that can show how specific financial management practices relate to profitability over time in Kenya are lacking. Such studies would help in understanding the dynamics that affect the growth and stability, (Sensini & Vazquez, 2020; Njenga & Jagongo, 2019; Sitharama & Hoque, 2016). Many other studies are carried out in regions or countries with different socio-economic settings where small enterprises encounter different problems from those prevailing in Kenya. For example, there have been contextual differences between regulatory environments, market dynamics, and cultural aspects both in Kenya and Indonesia, Nigeria, or South Africa; therefore, localized research is imperative (Omol et al., 2023; Ndungu, 2020).

There are great variations in the ways essential elements that influence SME profitability, including financial literacy, credit accessibility, and debt management are applied. The inconsistency in defining and measuring these factors in previous studies has resulted in varying outcomes. For example, local dimensions of financial literacy have not been incorporated into the perception among managers of Kenyan SMEs about what constitutes financially literate behavior and knowledge (Brown et al., 2022; Kimani, 2021; Arinda, 2019). Findings from studies conducted in other areas do not necessarily apply to the realities of the Kenyan market. Research conducted in other African countries such as Ghana, South Africa, and Nigeria does not bring out vividly all the factors that concern SME profitability in Kenya because some factors like financial management practices bear significant variations due to economic as well as cultural contrasts (Nthenge & Ringera, 2017). Addressing these gaps can yield insights tailored to enhancing the profitability and resilience of Kenyan SMEs.

1.2 Objective of the Study

To determine the effect of financial forecasting on the profitability of the top 100 SMEs in Kenya.

1.3 Research Hypothesis

H_0: Financial forecasting has no significant effect on the profitability of the top 100 SMEs in Kenya.

2.0 Literature Review

The review of previously published work formed a key component in this research study for its assistance in identifying key issues and settings anchoring the thesis work. The literature review is presented in sections.

2.1 Theoretical Literature Review

The study was anchored on financial literacy theory, which traces its roots to early writings such as Benjamin Franklin's guidance on sound money management and argues that individuals and business owners who possess stronger financial knowledge make better financial decisions, avoid costly mistakes, and enhance long-term stability. The theory highlights the value of financial skills-such as budgeting, forecasting, debt management, and investment judgment-in enabling SME owners to select profitable projects, manage risks, and sustain business growth, although critics note that it overlooks emotional, cultural, and structural factors that also shape financial behavior. Contemporary studies, including Ahmed et al. (2021), Nicolini and Cude (2022), and Setiawan et al. (2022), reinforce the link between financial competence and improved financial behavior, even though much of this evidence focuses on individuals rather than firms. Guided by this theoretical foundation, the current study applied financial literacy theory to evaluate how knowledge, skills, and forecasting practices influence SME profitability, emphasizing that strengthening financial capability and embedding it within managerial decision-making supports sustainable enterprise performance.

2.2 Empirical Review

The general effect of forecasting on SMEs has been widely examined in various studies. Evidence indicates that financial forecasting significantly enhances SME profitability by facilitating better decision-making, effective cash flow management, and improved long-term planning. A study by Chen, Diaz, Sensini, and Vazquez (2020) conducted in Hubei, China, focused on the use of working capital management to improve quality management systems. The study explored how capital management and financial forecasting affect business profitability in emerging economies and revealed a strong link between efficient forecasting and increased profitability. SMEs with robust financial forecasting strategies were found to optimize resource allocation and anticipate challenges, leading to improved profitability and growth. Didonet, Fearne, and Simmons (2020) conducted a study in the United Kingdom on the grocery sector, focusing on the dilemmas faced by SMEs when adopting strategies to improve performance. The study highlighted the strategic planning benefits that SMEs gain from engaging in both short- and long-term forecasting. This study noted that businesses that incorporated forecasting techniques experienced higher levels of financial stability and were able to respond effectively to market changes, which contributed to better profitability outcomes. Forecasting practices such as cash flow and demand forecasting allow SMEs to plan their operations and manage risks effectively.

Mutegi (2016) based his study on examining how debt and equity influence the profitability of enterprises listed on the Nairobi Securities Exchange. One study variable explained how financial forecasting impacts the output of SMEs in Nairobi. asserting availability of significant association in forecasting practices and profitability marks such as sales and sales markup. By focusing on a

sample of 42 SMEs and T-test and ANOVA used to analysis and draw statistical inferences, operational advantages that come with anticipating financial conditions and aligning resources accordingly were clearly brought out. Sitharam and Hoque, (2016) looked at factors affecting profitability of SMEs, this study was carried in South Africa. The research investigated role of financial forecasting in South African SMEs sector. The drive was to assess significance of financial forecasting attributes achievement of financial goals by SMEs. Utilizing the study population of 2000 SMEs which operate in different sectors of business and by applying structural equation modeling (SEM), the research found out that accurate financial forecasting significantly improved SMEs to have ability of adapting to changes in the market, leading to profit enhancement. Gaio and Henriques (2018) conducted a comparative study investigating the profitability of large firms and SMEs. To establish clear comparative variables, the study employed financial forecasting to assess the financial well-being of SMEs and established enterprises within the European Union (EU). Researchers aimed to understand how European SMEs utilize financial forecasting to enhance profitability in a competitive market environment. A sample of 54,654 firms within the EU were utilized in the study and applied regression analysis to assess the raw data collected through questionnaires. Key outcomes indicated financial forecasting plays a crucial role in aligning business strategies with market demands, enhancing overall profitability of both SMEs and Large firms.

2.3 Conceptual Framework

The conceptual framework is presented in Figure 1

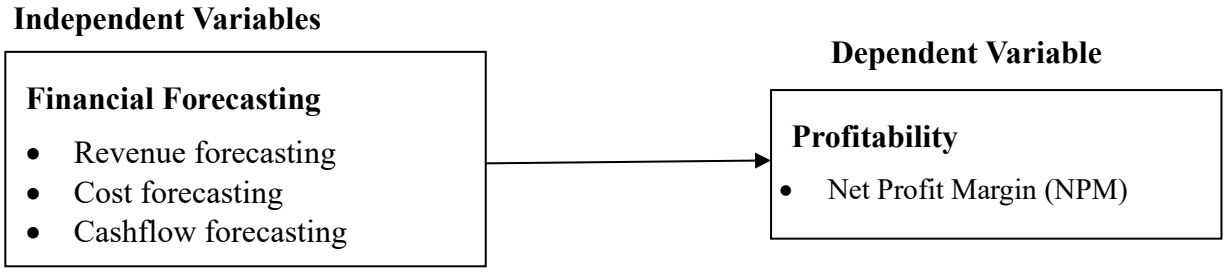

Figure 1: Conceptual Framework

3.0 Research Methodology

The study employed an explanatory research design under a positivist philosophy to investigate how financial forecasting influences profitability among Kenya's Top 100 SMEs. The population comprised top 100 SMEs between 2018 and 2023, with a census of 40 consistently listed firms selected for analysis. Data were collected through structured questionnaires for primary information and audited financial statements for secondary data. A pilot test involving 10 percent of the sample enhanced instrument precision, while validity was confirmed through expert review, factor analysis, and face validation, and reliability was determined using Cronbach's alpha with a threshold of 0.70. Data collection adhered to ethical standards, including university and NACOSTI

approvals, informed consent, and confidentiality assurances. Analysis was conducted using SPSS, producing descriptive, correlation, and regression outputs presented through tables and charts.

4.0 Research Findings and Discussions

This section presented a comprehensive analysis of the research data, including hypothesis testing and the detailed interpretation of findings. Each of the section is discussed in depth.

4.1 Response Rate

The response rate is a critical indicator of data quality and representativeness in survey research. Figure 2 presents the response rate achieved in this study.

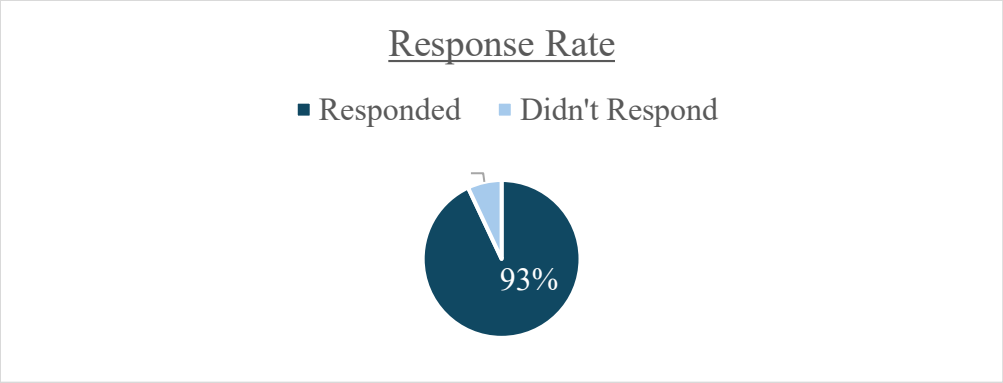

Figure 2: Response rate

Source: Research Data 2025

Out of 40 questionnaires distributed to the sampled SMEs, 37 were successfully returned, yielding a response rate of 93%. Only 3 questionnaires were not returned, accounting for 7% of the total distributed instruments. This response rate was considered robust and demonstrated adequate participation from the targeted SMEs in the study. According to Ericson et al. (2023), a higher response rate is ideal for the generalization of study findings and the development of viable conclusions.

4.2 Demographic Results

The demographic results revealed a balanced gender representation among SME leaders, with 54.1 percent male and 45.9 percent female respondents, reflecting a modest narrowing of the gender gap in business ownership in Kenya, though men still dominate the SME sector due to greater access to financial resources and networks. Most respondents were in the mature age brackets, with 54.1 percent aged between 41–50 years and 40.5 percent between 31–40 years, indicating that SMEs are primarily led by experienced and seasoned entrepreneurs. The educational profile of participants was notably high, as all respondents had post-secondary qualifications, with 56.8 percent holding bachelor's degrees and 32.4 percent master's degrees. This demonstrated a highly literate managerial base capable of applying advanced financial and managerial concepts, which enhances strategic decision-making and business sustainability.

In terms of organizational roles and firm characteristics, 75.6 percent of the respondents held top or managerial positions such as CEO, Managing Director, or Finance Manager, underscoring that the data was drawn from individuals with strong decision-making authority. Most firms (77.8 percent) had been in operation for over a decade, indicating a mature business environment with established operational frameworks. Similarly, the workforce data revealed that 78.4 percent of the firms were small enterprises employing between 10 and 50 staff, while 18.9 percent were medium-sized, showing the dominance of smaller operations within Kenya's SME landscape. Geographically, most businesses (75.7 percent) operated nationally, with 24.3 percent having international reach, suggesting that while many SMEs maintain a domestic focus, a significant share has expanded regionally or globally, reflecting Kenya's growing entrepreneurial competitiveness.

4.3 Descriptive Statistics Analysis

The descriptive statistics analysis was presented for the dependent and independent variables.

4.3.1 Profitability Margin

This section provided a detailed analysis of the descriptive statistics related to both independent and dependent variables. Data was obtained from participants' responses to structured questionnaire items. Measures such as frequencies, percentages, means, and standard deviations were used to summarize the data. These statistics helped to describe the general trends, patterns, and distribution of responses. The findings served as a foundation for further inferential analysis and interpretation. Profitability margin trends over time provide critical insights into the financial health and sustainability of SMEs. Table 1 presents the profitability margin movements of the sampled SMEs from 2018 to 2023.

Table 1: Profitability Margin

Year	0–5 (%)	6–10 (%)	11–15 (%)	16–20 (%)	20> (%)	Mean	S.D	Decision
2018	2 (5.4%)	26 (70.3%)	8 (21.6%)	1 (2.7%)	0 (0%)	9.18	3.41	Weak P Margin
2019	0 (0%)	26 (70.3%)	9 (24.3%)	1 (2.7%)	1 (2.7%)	9.89	3.35	Weak P Margin
2020	11 (29.7%)	21 (56.8%)	3 (8.1%)	1 (2.7%)	1 (2.7%)	7.43	4.43	Health P Margin
2021	5 (13.5%)	25 (67.6%)	5 (13.5%)	1 (2.7%)	1 (2.7%)	8.6	3.99	Health P Margin
2022	1 (2.7%)	25 (67.6%)	7 (18.9%)	2 (5.4%)	2 (5.4%)	10.12	4.28	Health P Margin
2023	26 (70.3%)	8 (21.6%)	3 (8.1%)	0 (0%)	0 (0%)	10.26	4.22	Health P Margin

Note:0–5% – Minimal Profit, 6–10% – Basic Profitability, 11–15% – Sustainable Profit, 16–20% – Strong Profitability, above 20% – Premium Profit. Decision rule-weighted Everage mean=3.95

Source: Research Data (2025)

An analysis of net profit margin trends from 2018 to 2023 revealed that the years 2020, 2022, and 2023 recorded healthy profit margins among SMEs, whereas 2018, 2019, and 2021 showed weaker performance, as illustrated in Table 1. This fluctuation could be attributed to the level of financial literacy, economic factors, policy shifts, and changes in operational efficiency across the years. Notably, the improved margins in 2022 and 2023 suggested a positive recovery trajectory for

SMEs following earlier periods of financial strain. These findings aligned with the International Monetary Fund (2021), which clearly indicated a decline in profitability of many businesses during the COVID-19 period of 2020-2022 and recovery beginning in 2023. Benedict *et al*. (2021) had the same findings. The attribute of financial literacy also came in as a way to adapt to changes and maintain the business posture after the pandemic period as indicated in the study done by Eniola and Entebang (2017) on the level of SMEs business owners' managers' financial literacy and its impact on the firm's performance.

4.3.2 Test for Financial Forecasting

Financial forecasting is a critical component of financial literacy that enables SMEs to anticipate future financial conditions and make informed strategic decisions. This section examined the financial forecasting practices of the sampled SMEs. The analysis covered the types of forecasting methods used, the ability to prepare forecasts, forecast accuracy, understanding of the importance of forecasting, confidence levels in forecast preparation, and the frequency of forecast reviews and revisions. The findings provided insights into how financial forecasting practices influenced the profitability of the top 100 SMEs in Kenya. The types of financial forecasting methods employed by SMEs reflect their sophistication in financial planning and resource allocation. Table 2 presents the distribution of financial forecasting methods used by the sampled SMEs.

Table 2: Type of Financial Forecasting

Type of Financial Forecasting	Frequency (n)	Percentage (%)
Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	1	7.7
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	4	30.8
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	2	15.4
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	3	23.1
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	1	7.7
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	1	7.7
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	3	23.1
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	2	15.4
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	2	15.4
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	1	7.7
Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, Balance Sheet Forecasting	3	23.1
Qualitative Forecasting, Long-Term Cash Flow Forecasting, Sales Forecasting, Income Statement Forecasting, Balance Sheet Forecasting, Scenario Forecasting	1	7.7
Sales Forecasting	1	7.7

Source: Research Data (2025)

The results in Table 2 reveal that a significant majority of the sampled SMEs adopted multiple combinations of financial forecasting methods, demonstrating an advanced understanding of financial management and planning. The most frequent combination, reported by 30.8% of the firms, included Long-Term Forecasting, Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, and Balance Sheet Forecasting. This shows that these enterprises prioritize a comprehensive and integrated approach to forecasting, covering both revenue and expenditure aspects of financial performance. Another 23.1% of the firms employed similar combinations that encompassed long-term and cash flow forecasting alongside profit and expense forecasts, indicating a strong emphasis on sustainability and financial control. Additionally, 15.4% of SMEs reported using the same extensive forecasting methods but with slight variations in inclusion or frequency, reflecting adaptive financial planning suited to their operational scale and market volatility.

A small proportion, 7.7%, relied solely on Cash Flow Forecasting, Sales Forecasting, Profit Forecasting, Expenses Forecasting, Income Statement Forecasting, and Balance Sheet Forecasting, suggesting that while they engage in structured forecasting, they may lack a long-term perspective. Another 7.7% applied Qualitative Forecasting combined with Long-Term Cash Flow and Scenario Forecasting, implying a more interpretive approach grounded in managerial judgment. Finally, only one SME (7.7%) utilized Sales Forecasting as a standalone method, signifying limited engagement with comprehensive forecasting tools. Overall, these findings indicate that most SMEs integrate diverse forecasting elements to manage financial performance strategically. The emphasis on long-term and cash flow projections underscores their commitment to financial stability and forward planning. This aligns with the conclusion by Sitharama and Hoque (2016) that diversified financial forecasting approaches enhance business performance and resilience in dynamic markets.

Ability to do financial forecasting

The ability of SMEs to prepare financial forecasts is fundamental to effective financial planning and decision-making. Table 3 presents the ability of the sampled SMEs to prepare financial forecasts across the study period.

Table 3: Test for ability to prepare the financial forecast

Year	Yes (%)	No (%)	Mean	S.D	Decision
2018	36 (97.3%)	1 (2.7%)	0.97	0.16	H-Proficiency
2019	37 (100%)	0 (0%)	1	0	Excellent
2020	37 (100%)	0 (0%)	1	0	Excellent
2021	37 (100%)	0 (0%)	1	0	Excellent
2022	37 (100%)	0 (0%)	1	0	Excellent
2023	36 (97.3%)	1 (2.7%)	0.97	0.16	H-Proficiency

Note: Decision rule-weighted Everage mean=0.99

Source: Source: Research Data (2025)

Table 3 clearly showed that in the four consecutive years—2019, 2020, 2021, and 2022—all SME respondents (100%) were excellently able to prepare financial forecasts, demonstrating strong knowledge of the forecasting process. In 2018 and 2023, only two SMEs lacked financial forecasts, resulting in a high overall proficiency rate of 97.3%. This aligned with the findings of Sitharama and Hoque (2016).

Accuracy of forecast

The accuracy of financial forecasts is essential for effective financial planning and resource allocation in SMEs. Table 4 presents the accuracy levels of financial forecasts prepared by the sampled SMEs from 2018 to 2023.

Table 4: Test for forecast accuracy

Year	1	2	3	4	5	Mean	S.D	Decision
2018	0 (0%)	1 (2.7%)	3 (8.1%)	31 (83.8%)	2 (5.4%)	3.92	0.49	Reflective
2019	0 (0%)	1 (2.7%)	3 (8.1%)	32 (86.5%)	1 (2.7%)	3.89	0.46	Reflective
2020	1 (2.7%)	6 (16.2%)	9 (24.3%)	19 (51.4%)	2 (5.4%)	3.41	0.93	Inaccurate
2021	0 (0%)	7 (18.9%)	6 (16.2%)	22 (59.5%)	2 (5.4%)	3.51	0.87	Inaccurate
2022	0 (0%)	0 (0%)	4 (10.8%)	31 (83.8%)	2 (5.4%)	3.95	0.41	Reflective
2023	0 (0%)	0 (0%)	3 (8.1%)	31 (83.8%)	3 (8.1%)	4	0.41	Reflective

Note:1-Not accurate 2- Sightly accurate 3-Moderatly accurate 4-Accurate 5-vVery accurate. Decision rule-weighted Everage mean=3.78

Source: Research Data (2025)

The analysis indicated that the financial forecasts made by SMEs in the years 2018, 2019, 2022, and 2023 were reflective, meaning they accurately represented the actual financial state. In contrast, the forecasts for 2020 and 2021 were inaccurate, failing to align with the actual outcomes. This discrepancy could be attributed to the economic disruptions during those years, possibly linked to external factors such as the COVID-19 pandemic. Overall, the variation highlighted the importance of context when evaluating the reliability of financial forecasting. The period with a decline in profitability was reported by the International Monetary Fund (2021). The analysis of the data also showed this period to be the period with significant deviation of forecasted figures from the original amounts.

Test for SMEs Understanding of Important of financial forecasting

Understanding the importance of financial forecasting is crucial for SMEs to prioritize and implement effective forecasting practices. Table 5 presents the level of understanding among the sampled SMEs regarding the importance of financial forecasting.

Table 5: Important of Financial Forecasting

Statistic	Description
Question	How would you evaluate your understanding of the importance of financial forecasting in enhancing the profitability of your SME?
Mean	3.92
Standard Deviation	0.277
Sample Size (N)	37
Observation	Most respondents rated their understanding as high, with frequencies concentrated between 3.5 and 4.5 on the scale.

Source: Research Data (2025)

With a mean score of 3.92 and a standard deviation of 0.277, the analysis conducted to assess understanding revealed that 4 SMEs (representing 8.1%) had a basic grasp of the importance of financial forecasting. In contrast, the remaining 33 SMEs (91.9%) demonstrated a strong understanding of the role financial forecasting plays in SME profitability.

Test of level of Confidence on preparation of financial forecast

Confidence in preparing financial forecasts reflects the self-efficacy and competence of SME managers in financial planning. Table 6 presents the confidence levels of the sampled SMEs in preparing financial forecasts.

Table 6: Confidence in Financial Forecast Outcomes

Confidence Level in Financial Forecast Outcomes	Frequency	Percentage (%)
Strong Confidence in Financial Forecasts	35	94.6
Uncertain or Lacking Confidence	2	5.4
Total	**37**	**100.0**

Source: Research Data (2025).

The results in Table 6 indicate that a significant majority of SMEs, representing 94.6%, demonstrated strong confidence in the reliability and usefulness of their financial forecasts. This suggests that financial forecasting is considered an essential decision-making tool among top-performing SMEs. Only 5.4% of the respondents expressed uncertainty or lacked confidence in using forecasts to predict future profits. These findings imply that most SMEs have integrated forecasting into their financial planning processes and perceive it as a reliable mechanism for guiding business growth and profitability.

Test for Review and Revision of Financial Forecast

Regular review and revision of financial forecasts enable SMEs to adjust their strategies based on actual performance and changing market conditions. Figure 3 presents the frequency of review and revision of financial forecasts among the sampled SMEs.

Note: 1-Never, 2- infrequently ,3- occasionally, 4- regularly. 5- continuously

Figure 3: Review and Revision of Financial Forecast

Source: Research Data (2025)

The analysis clearly shows that 3 SMEs (8.1%) review their financial forecasts infrequently, 25 SMEs (67.6%) conduct regular reviews, and 9 SMEs (24.3%) continuously review their financial forecasts. Notably, none of the SMEs (0%) reported never reviewing their forecasts, as illustrated in the figure below. This is further supported by a mean score of 4.08 and a standard deviation of 0.759, indicating that, on average, SMEs tend to review their financial forecasts regularly, with a moderate level of variation in how frequently this is done.

4.4 Hypotheses Testing

This section presented the findings of the hypothesis testing. The study adopted Pearson's correlation to test the relationship between each independent variable and the dependent variable-profitability. This parametric test was chosen as the most appropriate method due to the continuous and normally distributed nature of the composite scores derived from the data. The study rejected the null hypothesis when the p-value was less than 0.05 and failed to reject the null hypothesis when the p-value was greater than 0.05. The relationship between financial forecasting and SME profitability was examined to test the first hypothesis. Table 7 presents the regression model summary for financial forecasting and profitability.

Table 7 Regression Model Summary: Financial Forecasting and Profitability

Model	R	R^2	Adj R^2	Standard Error of Estimate	F	Sig	N
1	0.36	0.13	0.11	2.45	5.29	0.027	37

Predictor (constant), Financial forecasting

Source: Research Data 2025

Table 7 indicated that there was a statistically significant relationship between financial forecasting and profitability at the 5% significance level, as evidenced by a p-value of 0.027. The model showed an R-squared value of 0.13, meaning financial forecasting accounted for 13% of the variability in profitability. With a correlation coefficient (R) of 0.36, the relationship was moderate and positive. This direction clearly confirmed the result of the study done by Chen et al. (2020), which established a strong connection between financial forecasting and profitability aspects of firms established in China.

Table 8: Coefficient Table: Financial Forecasting and Profitability

	Unstandardized Coefficient β	SE	Standardized Coefficient β	t	Sig
Constant	5.20	1.30	0.000	4.00	0.000
Financial Forecasting	2.10	0.91	0.36	2.30	0.027

Dependent Variable: Profitability

Source: Research Data 2025

Table 8 above indicated that financial forecasting had a statistically significant and positive impact on profitability, as shown by a p-value of 0.027, which was below the 5% significance level. The unstandardized coefficient ($\beta = 2.10$) implied that for every one-unit increase in financial forecasting, profitability increased by 2.10 units. The standardized coefficient of 0.36 suggested a moderate positive relationship between the two variables. The constant value of 5.20 represented the expected level of profitability when financial forecasting was absent. These results confirmed that financial forecasting played a meaningful role in influencing profitability. Based on the results of the findings, H_0-Financial forecasting has no significant effect on profitability of SMEs- was rejected at the $\alpha = 0.05$ level of significance. Hence, financial forecasting has a significant effect on the profitability of the top 100 SMEs in Kenya.

5.0 Conclusion

The study concludes that financial forecasting serves as a statistically significant and strategic determinant of profitability among Kenya's Top 100 SMEs, functioning as both a protective mechanism against market uncertainty and a driver of profit growth. Effective forecasting enables enterprises to predict cash flow fluctuations, manage liquidity prudently, allocate resources efficiently, and identify profit-enhancing opportunities proactively rather than reactively. The positive relationship between forecasting and profitability demonstrates that SMEs with robust forecasting systems can better anticipate market changes, adapt to economic disruptions, and maintain competitive advantages through informed decision-making. However, profitability challenges persist due to inadequate forecasting accuracy during crisis periods, informal and undocumented forecasting practices, limited strategic financial planning despite technical

knowledge, and vulnerability to external macroeconomic shocks including currency depreciation and rising input costs that collectively erode profit margins and threaten long-term sustainability.

6.0 Recommendations

The study recommends that the Kenya MSME Authority should develop and implement standardized financial forecasting training programs targeting SME managers and owners to enhance predictive accuracy and practical application of forecasting techniques. The Kenya Association of Manufacturers should establish industry-specific forecasting benchmarking frameworks that enable SMEs to compare their practices against sector standards and identify areas for improvement. Financial institutions should integrate forecasting capability assessments into credit evaluation processes while providing technical support and advisory services to borrowers to strengthen their financial planning capacities. Policymakers should mandate periodic forecast reviews and documentation as prerequisites for SMEs seeking government support programs, tenders, or subsidies to institutionalize strategic financial planning practices that demonstrably improve profitability outcomes and business sustainability.

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