

**CONSTRAINTS FACED BY SMALL AND MEDIUM
ENTREPRISES IN ACCESSING BANK FINANCE IN
ELDORET TOWN KENYA**

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**A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE DEGREE OF MASTER OF SCIENCE IN
QUANTITATIVE RESEARCH METHODS IN THE SCHOOL OF
MATHEMATICS, STATISTICS AND ACTUARIAL SCIENCE MASENO
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DECLARATION

This research project is my original work and has not been presented to any other institution of higher learning, for the award or degree.

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ACKNOWLEDGEMENT

I am greatly indebted to my supervisors Dr. Edgar Otumba Ouko and Professor Peter B. Kibas for their tireless efforts and willingness to support and guide me. Last but not least, I would like to thank family for their understanding

DEDICATION

This work is dedicated to all those who are tirelessly seeking knowledge through research.

ABSTRACT

Small and Medium Enterprises (SMEs) play an important role in the economies of developed and developing countries, through creation of new jobs. Access to bank financial resources seems to be a major constraint to the growth of SMEs in the developing context. This study thus, aimed at finding out the constraints faced by SMEs in particular accessing bank financing. The study adopted the adverse selection theory of credit markets. This study adopted an explanatory and descriptive survey design. The target population for this study was 8175 registered SMEs in Eldoret central business district. A sample of 35 SMEs was sampled with 4 respondents randomly selected to raise a sample of 140 respondents. The response rate was 122 questionnaires. Data were analyzed using descriptive, χ^2 , t-test for mean differences and logistic regression. In this study, education (p-value = 0.004), number of years of business (p-value = 0.013), stage (2) (p-value = 0.025), turnover (p-value = 0.020) contributed significantly to the prediction while gender (p-value = 0.081), age (p-value = 0.974), business form (p-value = 0.467) and number of employees (p-value = 0.107) did not. From the findings, through assessment of Exp (B), when the number of employees is increased by 1 unit, the odds ratio is 2.262 times as large and therefore businesses are 2 times more times likely to obtain funding. The odds ratio is 3.537 times as large for males and this means that males are approximately 4 times as likely to obtain funding. However, age, education, business form, number of years of operation, stage of business and average turnover were found to be insignificant in obtaining funding. As shown by the study there is a high failure rate for small business mainly due to lack of access to finance to start-up and expand businesses. Rather than overemphasizing costly interventions to support small enterprises, the state should focus on eliminating the barriers created by excessive regulation and the absence of effective markets. Given that the level of access to finance is low, it is therefore imperative that management capability and financial management acumen be regarded as key to easy access for funding by the entrepreneurs themselves, and the parties involved in supporting and promoting them. Access to information about SMEs should be increased to ensure that all providers and potential providers of finance have a sufficient knowledge to assess the risk of SME applications for finance

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ABBREVIATIONS AND ACRONYMS

SMEs Small and Medium Enterprises

FSD Financial Sector Deepening

OECD Organization for Economic Co-operation and Development

CBD Central Business District

UNIDO United Nations Industrial Development Organization

EC European Commission

GoK Government of Kenya

GDP Gross Domestic Product

SPSS Statistical Package for Social Sciences

OPERATIONAL DEFINITION OF TERMS

SME finance: is the funding of small and medium- sized enterprises and represents a major function of the general business finance market

SME(s): The category of micro, small, medium- sized enterprises is made up of fewer than 50 employees and has an annual turnover not exceeding KShs. 1 million according to investopedia

GDP: A primary indicator used to gauge the health of country's economy and represents the total dollar value of all goods and services produced over a specific time period according to investopedia

Constraint (s): It is the state of being checked, restricted or compelled to avoid or perform some action such as the constraint to access funding

Funding: Act of providing financial resources, usually in the form of money or other values such as effort or time to finance a need, program and project usually by an organization or government according to Wikipedia.

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CHAPTER ONE

INTRODUCTION

1.1 Introduction and Background

The question of the availability of external finance to small and medium enterprises has engaged the minds of academic researchers and policy makers around the globe for a long time (Berger and Udell, 2004) and the question is not yet fully answered to date. Small and Medium Enterprises (SMEs) have played and continue to play a major role in economic and social development the world over. Ayyagari et al. (2007) estimate the contribution by SMEs, both in developed and developing economies to employment in the manufacturing sub-sector to be 60%. SMEs are the main source of economic growth in developed and developing countries alike (Stella, 2011). In the US for example, the SME sector is said to provide 67% employment and 61% manufacturing sector output, respectively. In Korea, there are over 30 million SMEs constituting about 99.9% of the enterprises and employing over 88.1% of the labour force. Similarly, in Kenya, SMEs are responsible for about 80% of employment and contributes about 40% to GDP (Stella, 2011). These examples demonstrate that SMEs are an integral part of the economy critical in spurring socio-economic development (Stella, 2011). In most economies, Kenya included, SMEs comprise approximately 99% of all firms and employ between them about 60% of the people (SME-RC, 2012). In many sectors, SMEs are responsible for driving innovation and competition. Globally SMEs account for 99% of business numbers and 40% to 50% of GDP (SME-RC, 2012). FSD Kenya (Financial Sector Deepening) strongly believes that in Kenya, SMEs have the potential to contribute significantly to economic growth and poverty reduction through increased production and employment (SME-RC, 2012). In many transitional economies, improved access to finance for firms is a driving force for growth. Business has its role in boosting and enhancing productivity. However, the banking sector remains dysfunctional because of weaknesses in legal and regulatory regimes in many transition countries. This has resulted in the inability of banks to

extend loans to all borrowers (Rashid, 2011). With the move towards market oriented economies, one of the noticeable changes of this phenomenon is the increase of foreign bank presence which brings about various benefits in many developing countries (Rashid, 2011). This study further indicates that the benefits here include the reduction of financial intermediation costs, the ability to access more financial credits, and financial sector improvement. Banks are important to all economies, since they are the main financiers in generating increased business activities. Beck, Demirguc-Kunt, and Peria (2008) show that SMEs around the world are able to access formal financial resources through credit loans from banks, and Haas, Ferreira, and Taci (2010) also confirm that effective banking systems help in promoting economic growth. Lending from banks facilitates new growth for business ventures, and banks are therefore key players in driving SME development to generate increased national growth rates (Beck et al., 2008; Rahaman, 2011). However, it is undeniable that banks have less interest in SMEs due to SMEs unreliable business practices and weak financial strength. Those in less advanced economies where there is poor financial reporting, high rates of corruption, and unstable economies according to Le et al. (2006) are more affected. Getting banks to lend in those circumstances tends to be of great concern, since SMEs are often unreliable in disclosing necessary financial information (Torre, Peria, & Schmukler, 2010) which hardly meets the bank's requirement standards. Therefore, in less developed markets, banks are less likely to lend to SMEs, at least as compared to elsewhere. With this situation, in most transition economies, SME access to finance constraint is cited as one of the greatest obstacles to increasing business activities and growth (Nam, 2006). In response to the urgent need for a country's growth and the aspiration to overcome SME finance constraints, government policies with a more favorable environment for banks are vital drivers in encouraging banks to embrace the SME sector in order to meet the mutual benefits. Access to finance is the lifeline of any enterprise to enable it to grow and to generate more output and employment creation. The theoretical recognition that financing gaps will always exist in the financial markets can be traced to existing literature. Information asymmetry informs the credit rationing in the financial markets. Information asymmetry arises because borrowers have inside information which lenders do not have. Borrowers most times use this information for their

own benefit to the detriment of the lender. Hence lenders face challenges in discriminating good and bad borrowers and increasing interest rates to all potential customers can lead to adverse selection rather than driving the bad borrowers out of the market. Though financing is cited as a major constraint in for SME growth, a survey of literature dealing with this matter indicates that there is a significant knowledge gap in the determinants of access to finance by SMEs in developing economies, more so in Kenya. This study therefore is intended to fill this knowledge gap.

1.2 Statement of the Problem

SMEs are important both in developed and developing countries in sparing growth and economic development through creation of new jobs (OECD, 2006). A major constraint in SME growth is shortage of both debt and equity financing (Carpenter & Peterson, 2002). It follows therefore that financing is necessary to SMEs so that they may be able to expand operations, develop new products, hire new staff, and acquire facilities. The question about the constraints faced by SMEs in accessing bank finance is important, though not much research has been done in order to understand why and how banks finance SMEs around the world and in particular in Kenya. The problem is further compounded by inadequate quality data on SMEs. More so, the data that is available is not consistently collected and monitored over time, this then leads to methodological challenges in researching SMEs' access to bank financing. To make sure that SMEs gain full benefit from the moving trend towards a transformation into a market economy, it is crucial to identify the issues confronting SMEs, and to evaluate their impact on their operations. Therefore, this study aims at establishing the underlying constraints that influence access to bank finance by SMEs.

1.3 Objectives of the Study

1.3.1 Major Objective

The major objective of this study is to find out the constraints faced by SMEs generally and in Eldoret town in particular accessing bank financing.

1.4 Specific Objectives

The specific objectives of this study were to:

- (a) To determine if the characteristics of the entrepreneur such as age, level of education affects access to bank finance.
- (b) To determine if the firm size, age, industry sector and legal structure affects its access to finance.
- (c) To determine if the type of financing sort limits access to bank finance.
- (d) To assess the extent to which the difficulties faced in obtaining finance and their impact on business and growth plans.
- (e) To establish the type of business support services accessed by SMEs that improve their chances of obtaining financing.

1.5 Research Questions

The study sought to answer the following research questions:

- 1) Do the characteristics of the entrepreneur affect access to bank finance?
- 2) Do firm characteristics affect access to bank finance?
- 3) Does the type of financing sought limit access to bank finance?
- 4) Are there difficulties faced in obtaining finance and what are their impacts on business and growth plans?
- 5) Do SMEs that have access to business support have better chances of obtaining financing?

1.6 Significance of the study

This research will contribute to the growing literature on SME finance. It will shed some light on the current constraints faced by SMEs in accessing bank and other external

debt financing. The study also will assist lenders to SMEs in formulating SMEs' friendly lending methodologies. The policy makers at the national and county level will benefit from the study in filling the financing gap identified which is not yet fulfilled by the commercial lenders in assisting the SMEs sector meet their financial needs by setting up appropriate funds to address the gap.

1.7 Scope of Study

This study on the constraints facing SMEs in Eldoret CBD was conducted within Eldoret CBD between July 2013 and November 2014, using a survey design and a sample of 122 of SMEs. The study focused on the constraints facing SMEs in Eldoret CBD. Specifically, the study evaluated the following key parameters; characteristics of the entrepreneur, firm size, age, industry sector and legal structure and the type of financing. The study also assessed the difficulties faced in obtaining finance and their impact on business and growth plans and whether firms that have access to business support have better chances of obtaining financing. The study technique was a cross sectional survey. The study also narrowed down the geographical scope by limiting the same to selected SMEs from various industries in Eldoret CBD, Uasin Gishu County owing to the diversity of business within the area.

1.8 Limitations of the study

Limitations are the significant and even salient issues that present themselves in a study and which the researcher cannot effectively control (Marilyn & Goes, 2013). The researcher may face reluctance by the respondents to give information on the topic of study. This will be mitigated by focusing on explaining and enhancing the understanding of the respondents about the objective of the study and especially that the data will be used only for academic purposes and that their identity is strictly private.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The important perspectives from demand side of SME access to finance is are investigated in this chapter.

2.2 Overview, Definition and Classifications of SMEs

The issue of what constitutes a small or medium enterprise is a major concern in the literature. Different authors have usually given different definitions to this category of business. SMEs have indeed not been spared with the definition problem that is usually associated with concepts which have many components. The definition of firms by size varies among researchers. Some attempt to use the capital assets while others use skill of labour and turnover level. Others define SMEs in terms of their legal status and method of production. Storey (1994) tries to sum up the danger of using size to define the status of a firm by stating that in some sectors all firms may be regarded as small, whilst in other sectors there are possibly no firms which are small. The Bolton (1971) Committee first formulated an "economic" and "statistical" definition of a small firm. Under the "economic" definition, a firm is said to be small if it meets the following three criteria: It has a relatively small share in their market place, it is managed by owners or part owners in a personalized way, and not through the medium of a formalized management structure and it is independent, in the sense of not forming part of a larger enterprise. Under the "statistical" definition, the following criteria was used: The size of the small firm sector and its contribution to GDP, employment and exports, the extent to which the small firm sector's economic contribution has changed over time and applying the statistical definition in a cross-country comparison of the small firms' economic contribution. The Bolton Committee applied different definitions of the small firm to different sectors. Whereas firms in manufacturing, construction and mining were defined in terms

of number of employees (in which case, 200 or less qualified the firm to be a small firm), those in the retail, services, wholesale, etc. were defined in terms of monetary turnover (in which case the range is 50,000 - 200,000 British Pounds to be classified as small firm). Firms in the road transport industry are classified as small if they have 5 or fewer vehicles. There have been criticisms of the Bolton definitions. These centre mainly on the apparent inconsistencies between defining characteristics based on number of employees and those based on managerial approach. The European Commission (EC) defined SMEs largely in term of the number of employees as follows: firms with 0 to 9 employees - micro enterprises; 10 to 99 employees - small enterprises and 100 to 499 employees - medium enterprises. Thus, the SME sector is comprised of enterprises (except agriculture, hunting, forestry and fishing) which employ less than 500 workers. In effect, the EC definitions are based solely on employment rather than a multiplicity of criteria. Secondly, the use of 100 employees as the small firm's upper limit is more appropriate, given the increase in productivity over the last two decades (Storey, 1994). Finally, the EC definition did not assume the SME group is homogenous; that is, the definition makes a distinction between micro, small, and medium-sized enterprises. However, the EC definition is too all-embracing to be applied to a number of countries. Researchers would have to use definitions for small firms which are more appropriate to their particular "target" group (an operational definition). It must be emphasized that debates on definitions turn out to be sterile, unless size is a factor which influences performance. For instance, the relationship between size and performance matters when assessing the impact of a credit programme on a target group (Storey, 1994). The UNIDO also defines SMEs in terms of number of employees by giving different classifications for industrialized and developing countries (see Elaian, 1996). The definition for industrialized countries is given as follows: Large - firms with 500 or more workers; Medium - firms with 100-499 workers and small - firms with 99 or less workers. The classification given for developing countries is as follows: Large - firms with 100 or more workers; Medium - firms with 20 - 99 workers; Small - firms with 5 - 19 workers and Micro - firms with less than 5 workers. It is clear from the various definitions that there is not a general consensus over what constitutes an SME. Definitions vary across industries and also across countries. In Kenya, the following

definitions of the SME sector are applied Micro Enterprise has 1-10 number of employees with a turnover of Kshs 0-5 million, Small Enterprise 11 - 50 employees with turnover of Kshs 5-50 million and Medium enterprises has 51- 100 employees and turnover of Kshs 51 million -1 billion (GoK, 2005). Despite the important contribution to economic growth by SMEs they continue to face numerous challenges including; inadequate infrastructural facilities, challenges with attracting skilled manpower, high rate of enterprise mortality, lack of a facilitative operating environment, restricted market access, and onerous regulatory requirements. However, one of the main areas of concern is access to funding (Stella, 2011). SMEs require adequate financing to meet needs at each stage of their life cycle, from creation through operation, development, expansion, and beyond. Financing is necessary to help them set up and enhance their operations, develop new products, and invest in new staff or production facilities (Stella, 2011). Many small businesses start out as an idea from one or two people, who invest their own money and probably turn to family and friends for financial help in return for a share in the business. But if they are successful, there comes a time for all developing SMEs when they need new investments to expand or innovate further. Access to funding and the high cost of finance through the traditional channels have been major constraints to SMEs hence the need to explore alternatives (Stella, 2011).

2.3 Contributions of SMEs to Economic Development

SMEs contribute to a country's GDP in two ways-by either manufacturing goods of value, or through the provision of services to both consumers and/or other enterprises. This encompasses the provision of products and, to a lesser extent, services to foreign clients, thereby contributing to overall export performance. In Kenya, SMEs represent majority of informal businesses and contribute significantly to Kenya's GDP and employment (Berry et al., 2002). From an economic perspective, however, enterprises are not just suppliers, but also consumers; this plays an important role if they are able to position themselves in a market with purchasing power: their demand for industrial or consumer goods will stimulate the activity of their suppliers, just as their own activity is stimulated by the demands of their clients. Demand in the form of investment plays a dual role, both

from a demand-side (with regard to the suppliers of industrial goods) and on the supply-side (through the potential for new production arising from upgraded equipment). In addition, demand is important to the income-generation potential of SMEs and their ability to stimulate the demand for both consumer and capital goods (Berry et al., 2002).

2.4 Constraints Facing SMEs in Accessing Bank Financing.

2.4.1 Gender and Access to Credit

The significance of the gender implication in this empirical research, results from a general perception that female applicants are viewed as more risk averse than male applicants. Also, the property ownership in the African family set-up favours men over women. Female and male entrepreneurs generally differ in the way they finance their businesses (Verhuel & Thurik, 2001). As reported in the enterprise literature, the issue of differences in financing sources related to gender among SMEs is more highlighted during the introductory (start-up) stage. For example, Verhuel and Thurik (2001) found that although men and women do not significantly differ with regard to the type of capital, women SMEs owners appear to have a smaller amount of start-up capital. In addition, women-owned SMEs begin in business with less than half of capital amount used by men and face more credibility issues when dealing with bankers (Badulescu, 2011). In parallel, Mijid (2009) found higher loan denial rates and lower loan application rates among female entrepreneurs. Coleman (2007) also provided evidence of credit discrimination against female entrepreneurs as they were more frequently charged higher interest rates and asked to pledge additional collateral in order for loans to be granted. Explanations given in the literature for differences between men and women entrepreneurs with respect to access to finance can be categorized into discrimination, abilities and preferences, and competition (see Harrison & Mason, 2007). Moreover, Verhuel and Thurik (2001) divided the impact of gender on SMEs capital into direct and indirect effect. The former "gender effect" refers to the fact that while male and female entrepreneurs may share characteristics but they are different in the way in which they finance their firms. However, the latter "female profile" can be more attributed to differences related to business type, management and experience. However the gender implication in accessing finance has to tested within the

Kenyan framework.

2.4.2 Age and Access to Credit

It is often found that the personal financing preferences of entrepreneurs appear to change according to age. According to Romano et al. (2001), the effect of the owner–manager’s age on the financial behaviour of SMEs can be noted in that unlike younger entrepreneurs, older entrepreneurs are less likely to invest additional finance into their firms. Older SME owner–managers are more reluctant when it comes to accepting external ownership in the firm. Further, Vos et al. (2007) examined SME financial behaviour utilizing two data sets from the UK and the US consisting of 15 750 and 3 239 SMEs, respectively. The results show that younger owner–managers tend to use more bank overdrafts and loans, credit cards, own savings, and family sources than older owners who appear to be more dependent on retained profits. Clarifying the connection between the financial growth cycle of SMEs and the owner–manager’s life cycle, Briozzo and Vigier (2009) state that as the firm and its owner grow older, information asymmetries decrease, granting easier access to debt (a supply-side effect), while the owner’s risk aversion and personal costs of bankruptcy increase with age, and thus he or she desires to use less leverage (demand side effect).

2.4.3 Education Level and Access to Credit

Employed by institutional financiers as a proxy for human capital, the educational background of the SME owner–manager is often positively related to the firm’s usage of leverage (Coleman, 2007). As for the demand side, Storey (1994) asserts that higher levels of education provide entrepreneurs with greater confidence in dealing with bankers and other funders when applying for loans. Turning to experience, as measured by the number of years in an industry, Coleman (2007) found that experience also enhances the availability of credit. In fact, Nofsinger and Wang (2011) hypothesized that the experience of the entrepreneur is one factor that explains the difference in external financing levels available to SMEs. The findings of the study proved this hypothesis. They further explained that prior experience in the industry positively correlates with the share of external financing

in the firm and added that the cumulative experience of the owner–manager plays a crucial role in overcoming some of the problems that hinder SME access to external finance, including information asymmetry and moral hazard. From the lender’s perspective, as experienced entrepreneurs are believed to be better performers than less experienced entrepreneurs, it is then rational to factor experience into the process of evaluating the creditworthiness of SMEs (Gompers et al., 2010).

2.4.4 Ownership Structure and Access to Credit

There is a positive relation between SME leverage and the type of organizational structure (Coleman & Cohn, 2000). This is in line with Abor (2008) who identified the form of business as one of the factors explaining the capital structure decisions of Ghanaian SMEs. In addition, ownership structure and the type of firm were found to have a significant impact on the use of bootstrap financing. Owners launching firms organized as either a sole proprietorship or non-construction/manufacturing firms should be prepared to use more bootstrap financing than other firms. Owners of these types of firms should be prepared to develop a financial plan that incorporates the use of greater variety of financing alternatives than owners of firms organized other than a sole proprietorship non-construction/manufacturing firms. As such, a sole proprietorship of non-construction/manufacturing firms should recognize the potential for the associated greater number of constraints and difficulties in raising start-up capital. From the financier’s point of view, as SMEs are by nature characterized by concentrated ownership and control in the same owner–manager, which leads to maximizing the information asymmetry problem, the reluctance in lending to SMEs and the extensive use of collateral are understandable and justified. Consistent with this, the lack of separation between the firm and the owner affect the financing preferences of the firm. In terms of legal form, Cassar (2004) notes that incorporation may be perceived by banks and other finance suppliers as an encouraging sign of the firm’s formality and creditability. Consequently, incorporated firms appear to be in a very favored position in receiving external funding in comparison with unincorporated firms. Other studies (Storey, 1994) concluded that limited private companies are more likely to be reliant on bank financing.

2.4.5 Economic Sector and Access to Credit

A number of studies evidenced that factors related to the industry sector in which a firm operates also explain capital structure and financial decisions (Mackay & Phillips, 2005). Firms in the services sector, for example, can differ from those operating in manufacturing or construction in terms of financial needs and choices. Different capital structure determinants across time and industries have been analyzed empirically. The findings on the impact of industry were summarized on short-term and long-term debt varies greatly across industries and some differences in the funding preferences of the SMEs across industries were noted. SMEs in the agriculture sector and medical industries rely more on long-term and short-term debt than their counterparts in manufacturing. Abor (2007) further concluded that short-term credit is more used in wholesale and retail trade sectors compared with manufacturing SMEs, whereas construction, hotel and hospitality, and mining industries appear to depend more on long-term finance and less on short-term debt.

2.4.6 Size and Age of the Business and Access to Credit

Even though there is no agreement amongst researchers about the criteria that should be used to measure the size of the firm (typically total assets, sales or the number of employees), the notion that firm size has an effect on SME's activities and its potential to expand appears to receive some consensus. A firm's size is usually coupled with its age as they tend to have similar influence on the firm's life cycle. This influence can be strongly seen in the decision making process in the firm about whether one particular sort of finance should be chosen and utilized (Cassar, 2004). Studying firms financing and capital structure using a sample consisted of 292 Australian firms, Cassar (2004) concluded that the "larger" of the small firms rely more on long-term debt and external financing, including bank loans. This is consistent with Storey (1994) who found that in the case of SMEs, the owner-manager's personal savings are more important as a source of funds during the start-up stage than outside finance such as loans and overdrafts from banks. From another perspective, the extent to which firm size can impact the availability of finance to the firm was measured. They argued that as firms grow, they

develop a greater ability to enlarge the circle of banks from which they can borrow. They then provided evidence that firms dealing with multiple banks and credit institutions are nearly twice as large as those with only one bank. As younger firms are usually characterized by informational opacity (Berger & Udell, 2004) as a consequence of not having an established track record, this may lead to the reluctance of banks and other financial institutions to lend to these firms. According to Klapper, Sarria-Allende and Sulla (2002), younger enterprises (those established less than four years), are more reliant on informal financing and far less on bank financing. Quartey (2003) who concluded the significant positive effect of firm age on the ability to access external finance supports this. In addition, in their investigation of the impact of firm and entrepreneurial characteristics on SME access to debt finance in South Africa, Fatoki and Asah (2011) observed that SMEs established more than five years have a far better chance to be successful in their credit applications compared with SMEs established for less than five years.

2.5 Theoretical Framework

Finance theorists view of access to credit (referred to as credit rationing) exists due to adverse selection, moral hazard and contract enforcement problems. The adverse selection theory of credit markets originates with the paper by Stiglitz and Weiss (1981) in which they explained why the interest rate could not equate the supply and demand in the credit market, thus creating a financial gap. As discussed by Stiglitz and Weiss (1981), borrowers have inside information concerning the nature of the business activities they want financed. They gain substantial rewards from misrepresenting facts about their businesses. While the lender gains if the loan is repaid with interest, it will not participate in sharing of the profits beyond the interest if the firm performs well. It is, however, a victim of any downside losses in the case of default. Lenders like banks therefore face difficulties in discriminating between good and bad credit risks. And to guard themselves against these risks, they simply increase the interest rate or place stringent collateral requirements (Ghimire & Abo, 2013) to all potential borrowers. This in turn can lead to adverse selection in that, rather than driving potential non payers out of the market, there may be systematic reasons why some of the highest risk firms are those willing to

pay high interest rates (Pollard, 2003).

The other problem, moral hazard can arise when lenders are unable to discern how borrowers' actions would affect the distribution of returns from an investment. This means, after a lender has extended finance to a firm they are exposed to moral hazard, the risk that the firm will not perform in a manner sufficient to meet the contract. For example, once a loan has been secured, a borrower could use the proceeds of the loan for a higher risk purpose or a non-income generating activity, necessitating costly ex post monitoring of the financial contract. The third reason to cause credit rationing is the contract enforcement problems. Credit market imperfections in developing countries derive not only from moral hazard and adverse selection problems but also from costly monitoring and contract enforcement. In contrast, countries characterized by well-functioning legal systems, the problems are not as pronounced as in those where the mechanisms for enforcement of contracts, property verification and ownership are weak. Hence, the main reason for the contract enforcement problem is the poor development of property rights. Although this argument is not specifically prawn to SMEs alone, these problems are more associated with SMEs than large companies.

The above literature review demonstrates that information and enforcement problems inherent in credit transactions can lead to imperfect credit markets. Tucker and Lean (2001) highlight the aspect of information asymmetry in SME lending. It is also clear from the above arguments that the small firms' access to financing may either come from supply side market failure (rejection from the banks' side for reasons not connected with the viability of the proposal or high risk and costs associated with such loans) or demand side market failure (insufficient information in the project proposal, high cost of bank credit etc). Figure 1.1 describes the information asymmetry in small firm lending as pointed out by Tucker and Lean (2001).

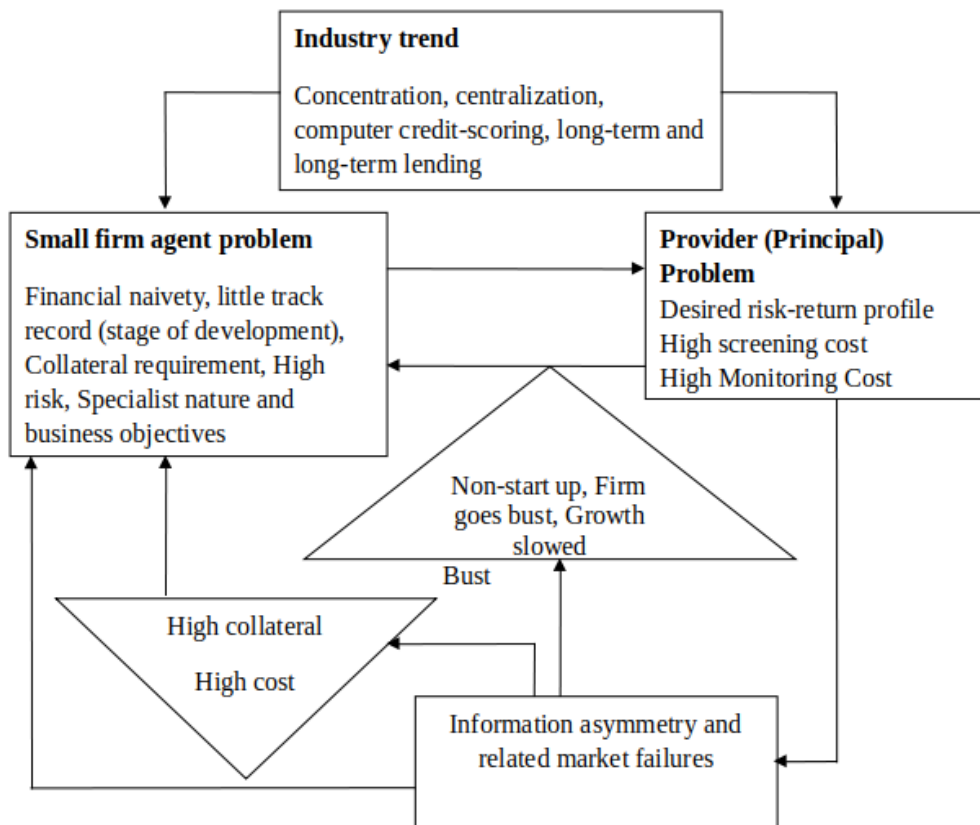


Figure 2.1: Information asymmetry in Small firm lending

Source: Tucker and Lean (2001)

2.6 Conceptual Framework

The conceptual framework contains independent and dependent factors. Bryman (2008) point out that the factors are alluded to as the building pieces of hypotheses. The conceptual framework contains three independent factors. They incorporate entrepreneurial characteristics, business characteristics and loan duration. This is represented in Figure 2.1.

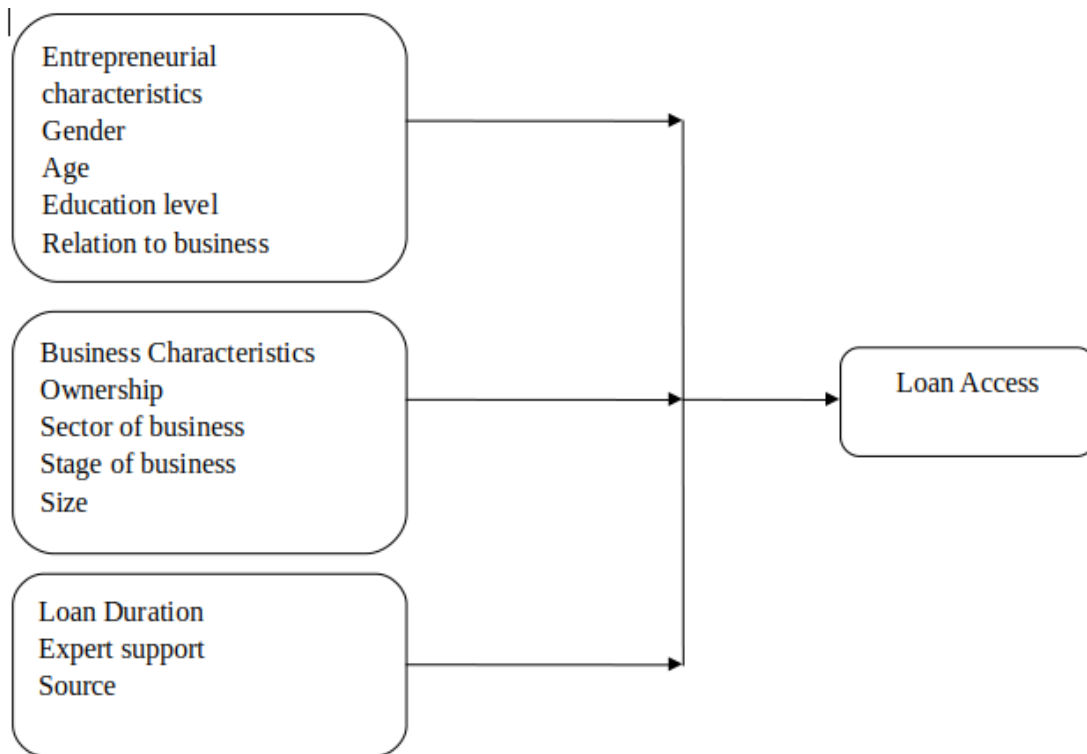


Figure 2.2: Conceptual Framework

Source: Researcher (2016)

2.7 Summary of literature and research gap

As a developing country, Kenya has significant economic growth potential. Consistent with sustainable development goals, one of the Kenya's vision 2030 is to decrease the number of people who financially excluded with special attention has been accorded small and medium owned enterprises. The government has established mechanisms of strong financial systems by establishing deregulations governing access of finances. The partnership of Central Bank of Kenya with the Financial Sector Deepening (FSD) Kenya and other financial sector players and stakeholders have been formed under the private-public partnership arrangement, with the aim of continuously monitoring and measuring the level of financial access (FinAccess, 2009) particularly among SMEs. Africa as a whole has made efforts towards credit access with Kenya having been ranked among 30 developing countries that is scoring high on financial or credit access (Jain, Zubenko & Carotenuto, 2014). In today's dynamic and turbulent world, SMEs that employ compet-

itive strategies tend to have a superior performance over their competitors. Large firms enjoy the advantage of being well organized with stable strategies to run the companies being put in place and it is obvious that such firms' strategy will position it to access credit. SMEs are mostly guided by the owners' characteristics which is an indicator to the level of decisions taken in that firm as well as the firm characteristics. Access to credit is inarguably a prerequisite of high performance of an SME as it has been supported by numerous studies done before. Researchers have also examined factors that lead to a firm to be credit worthy such as availability of the financial services which is a supplier factor and financial literacy. However, there is a gap to identify the constraints faced by SMEs generally and in Eldoret town in particular in accessing bank financing. More so, entrepreneur and firm characteristics and how they affect accessing bank financing. In addition, there is little research on how the type of financing limits access to bank finance and whether there are challenges faced in obtaining finance.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Aspects of the research method to be covered in the chapter include the basic type of research design, a definition of the population, the measurement instrument, the data collection methods used and the statistical techniques applied to analyze the data. The chapter starts by revisiting the problem statement and the research objectives.

3.2 Research design

The research design is the plan and structure of investigation so conceived as to obtain the answers to the research question. This study adopted quantitative research design.

3.3 Target Population and sampling frame

A population must be defined in very specific terms to include only those units with characteristics that are relevant to the problem (Wegner, 2003). Two distinct populations were targeted in the current study. The populations for the current study are defined as the entrepreneurs and the financial institutions. Zikmund et al. (2010) describe the target population as the complete group of specific population elements relevant to the research project. For the purposes of this research, the target population comprises entrepreneurs from the small medium and micro enterprises level. The population of study comprised registered SMEs in Eldoret Municipality. Consistent with the nationally accepted definition of SMEs, the study targeted SMEs in Eldoret Municipality employing staff from 0 - 49 (KNBS, 2016). The geographical location is Eldoret Municipality. It is possible to construct a so called sampling frame, having defined the population. A sampling frame is a listing of all the elements in a population and the actual sample is then drawn from this listing. It is possible that biases could exist between the opinions of members of the sample frame and population. Therefore, the adequacy of the sampling frame is crucial

in determining the quality of the sample drawn from it. Sample frames may differ from the population in the following ways: the frame may contain ineligibles or elements that are not part of the population and the frame may contain duplicate listings, and the frame may omit units of the population, which is by far the most serious problem. There are approximately 8175 SMEs in Eldoret town by the year 2012 (Loice, Chepkwony and Menjo, 2012). This makes up the target population for the study. The SMEs comprised those in the manufacturing, finance and services sectors and were evenly spread across the CBD.

3.3.1 Sampling technique

Techniques that make use of probability theory can both greatly reduce the chances of getting a non-representative sample and, permit precise estimation of the likelihood that a sample differs from the population by a given amount.

3.3.2 Sample size

Given that this is a cross-sectional data set, sometimes random sampling is not appropriate as an assumption for analysing cross-sectional data because some entrepreneurs might choose not to participate in the research. Hence, we used purposeful method to choose our sample for study.

3.4 Research instrument

Instruments refer to the tools to be used for collecting data and how the tools were developed, Oso and Onen (2005). The study utilized primary data derived from interviews using structured questionnaires. Questionnaires are best suited for surveys (Saunders et al., 2007) and in particular studies on SME's. To collect primary data, questionnaires were used. Sekaran (2013) suggests that questionnaires are efficient data collection apparatus which provide the researcher to know exactly what is necessary and how to measure the variables of interest. Upon approval of the research proposal, the researcher sought appointment with dean's office to approve the carrying out of the research conduction in the town. There are four basic types of measurement options. 3.5 Validity and Reliability

of the Instruments

3.4.1 Validity

According to O’leary (2009) validity is premised on the assumption that what is being studied can be measured and captured. It is the degree to which a research instrument is able to measure what was intended to measure. Validity refers to degree to which evidence supports any inferences a researcher makes based on the information collected using particular instrument (Fraenkel, Wallen & Hyun, 2012). In this study, content validity and face validity were tested. Content validity, concerns the representation by the instrument of the content of a given construct ,in terms of measurement, substance and straightforward definition of the construct (Vitari, 2006) while face validity refers to the extent to which the measured variable appears to be an adequate measure of the conceptual variable. The judgment of whether the empirical measure appears to measure the same thing as the ”actual” construct. Expert Opinions Literature searches were sought by brainstorming the questionnaire with colleagues upon which necessary corrections were done.

3.4.2 Reliability

According to Pantan (2000) reliability is the quality attributed to proposition or measures of the degree to which they conform to establish the truth. For this study, reliability is to be achieved through a pilot test. The research employed the use of questionnaires. The purpose of construct reliability is to show that the items measured are correlated with what they purport to measure and that the items do not correlate with other constructs.

3.5 Data collection

There is no simple answer as to which of the available methods of data collection the researcher should use when collecting data. The survey was done via mail and a telephone survey was done as a follow-up to non-respondents. For the more informal business sector, questionnaires were handed out at business centers.

3.5.1 Format of the questionnaire

A questionnaire was sent out, focusing on the entrepreneurs in the Eldoret Central Business District as unit of analysis. The questionnaire was structured as follows: Entrepreneur Characteristics Information: This section used close-ended questions to gather information such as gender, age, and education. Participants were simply expected to click the space containing the applicable response. The questions in this section were either in multiple choices and some in text format which allowed participants to choose one or more alternatives in some instances. The rationale behind these entrepreneur characteristics questions is that it places the results in a frame of reference and might provide insights into differences between entrepreneur groups or correlation with regards to entrepreneurial behaviour. Profile of business activities: Close-ended and open ended questions were used to gather information such as the number of years of experience as an entrepreneur. Their position or role in the business and whether the business is micro, small or medium sized. Entrepreneurs were also asked how they raised start-up capital, which financial institutions they approached for financing and at which institution their application was successful. Finally, entrepreneurs were asked to indicate what obstacles they experienced during the application process and whether they need training in motivation, entrepreneurial or business skills. The questionnaires were distributed with an introduction letter (see appendix). The covering letter included the following: An explanation of the relevance of the study, a brief description of the objectives of the study, instructions on how to administer the questionnaire, assurance of confidentiality and contact details if any difficulties were encountered a copy of the questionnaire is attached as appendix A.

3.6 Data analysis and statistical techniques used

The discipline of statistics can be divided into two broad areas: descriptive and inferential statistics (Walton, 2007). The author defines inferential statistics as the area of statistics, which deals with the generalization of the information extracted from a sample to the actual environment in which the problem arises.

3.6.1 Descriptive Statistics

Descriptive statistics used in the present study include frequency counts, mean scores, standard deviations and cross tabulations. Frequencies are defined as the number of objects in sets or subsets. More simply, the number of times a certain answer appears in the data. In order to describe the responses of the respondents toward each question they were asked in the survey, the frequency and percentage of responses were computed. In addition, the mean and standard deviation for some of the variables was calculated where the mean shows the central tendency of the data and the standard deviation measures the dispersion which offers an index of the spread or variability in the data (Sekaran, and Bougie, 2013). A cross tabulation is just a more advanced method of presenting frequency data. It presents the frequencies in a matrix. For instance: Number of entrepreneurs in each race group within each gender.

3.6.2 Inferential statistics

The study used a chi-square test to test the degree of association between the independent variables and dependent variable (access to bank credit or finance). The chi-square Test (χ^2) test procedure tabulates a variable into categories and computes a χ^2 statistic. This goodness-of-fit test compares the observed and expected frequencies in each category to test either that all categories contain the same proportion of values or that each category contains a user-specified proportion of values. This is the significance test used when making use of the cross-tabulation technique.

3.6.3 Statistical significance

Test statistics such as the inferential techniques described above, are used to tell the researcher about the true state of the population inferred from the sample. Field (2005) explains that there are two possibilities in the real world (in the actual population): there is, in reality, an effect in the population or there is no effect in the population. Although there is no clear way of knowing the true situation, Fields (2005) explains that by looking at the test statistically and the associated probability, one can decide which of the two is the most likely. A general decision rule is set against which the p-value is evaluated when

deciding whether the observed effect in the sample is true also for the population. For the current study this is 0.05. Therefore, all p-values less than 0.05 are considered as an indication of an effect in the population. All statistical analyses in the present study were computed using the SPSS (Statistical Package for the Social Sciences) statistical package for Windows version 16.

3.7 Ethical Considerations

Permission to carry out the study was sought from the relevant authority and from the SMEs who participated in the study (Kombo & Tromp, 2009). The researcher took into account the effects of the research on individuals, and acted in a way that protects their decorum. In this study, the researcher assured all the respondents that the information given would be used for academic purposes only. This was done to ensure honest information was given and also to enhance the process of data collection. The researcher assured the participants that nobody would be questioned about any information they give, moreover, no names or personal identification numbers were reflected in the questionnaire, the numbering of the questionnaires were for ordering purpose only.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1 Introduction

The current chapter presents the empirical research findings of the study which focused on assessing obstacles in the access to Small, Medium and Micro Enterprise finance. The analysis is based on 122 responses out of the 140 questionnaires that were sent out to entrepreneurs. This means that the response rate was 87% which is adequate for analysis. A survey response rate is viewed as an important indicator of survey quality and it is presumed that a higher response rate ensures more accurate survey results. Firstly, the results of the "Entrepreneur survey" are presented. The first section of these results presents the structure of this sample in terms of the demographic profile of the sample. The second section provides the profile of the business operations of the entrepreneurs. The next section looks at the business financing used and challenges facing business in terms of financing. The last section compares certain demographic groups in terms of their views on financing problems experienced.

4.2 Demographic profile of respondents

The study sought to establish the demographic characteristics of the respondents as well as their businesses. This would provide a basis through which the characteristics would be assessed against the independent factor which was access to finance. Characteristics such as gender and age also provide a means of understanding the finance market orientations and determine whether there is any form of discrimination in access to finance basing on these characteristics. The findings regarding this were summarized and presented in Table 4.1 and Table 4.2.

Table 4.1: Gender and age

Gender	Frequency	Percent
Male	90	73.8
Female	32	26.2
Total	122	100
Age Bracket (years)	Frequency	Percent
18 to 24	8	6.6
25 to 34	25	20.5
35 to 44	46	37.7
45 to 54	37	30.3
55 to 64	6	4.9
Total	122	100

The findings in Table 4.1 revealed the majority of the entrepreneurs, 90 (73.8%) were male while females comprised less than 30% of the total number of entrepreneurs assessed. This shows that majority of the businesses in Eldoret Municipality are dominated by males. Furthermore, the findings also revealed that majority of the respondents, 46 (37.7%) were aged between 35 to 44 years which was followed by those between 45 to 54 years, 30.3% and 25 to 34 years of age, 20.5%. From this finding, over 87% of the entrepreneurs are aged between 25 to 54 years while other age groups comprise less than 12% of the total. This also indicates domination of the business sector by those who are middle aged as compared to the younger and older entrepreneurs. These age groups are again economically more active compared to other age groups. The study also sought to establish the education background of the entrepreneurs and their relation to the business. Access to education as well as the level of education access provides a means of understanding how this is related to the perception of finance providers. The findings were summarized and presented in Table 4.2.

Table 4.2: Education and relation to business

Highest Education Level	Frequency	Percent
Secondary	8	6.6
Tertiary	58	47.5
University	54	44.3
Vocational	2	1.6
Total	122	100
Relation to Business	Frequency	Percent
Owner Manager	50	41
Partner	12	9.8
Director	60	49.2
Total	122	100

From the findings in Table 4.2, it was revealed that majority of the entrepreneurs, 58 (47.5%) had attained tertiary education. This was mainly those who attained tertiary colleges which mainly offer diploma certificate courses. The findings also showed that 54 (44.3%) of the entrepreneurs had attained university education. Those who had secondary and vocational training comprised less than 10% of the total. Education attained means that the individual would have a higher propensity of having the required knowledge in running the business and hence higher propensities of attracting and accessing financial support from the finance providers. The findings also revealed that majority of the respondents, 60 (49.2%) were directors in their businesses while 50 (41%) were managers who were owners of the business as well. Partnerships were less than 10%. A χ^2 test of independence was used to compare the frequency of success of obtaining funding for their businesses between different independent factors such as gender, age, highest level of education and relation to the business. The findings were summarized and presented in Table 4.3 and Table 4.4.

Table 4.3: Association between gender and success in obtaining funding

		Obtained funding			χ^2	df	p-value
		Successful	Not successful	Total			
Gender	Male	52	38	90	5.177	1	0.023
	Female	11	21	32			
	Total	63	59	122			

The findings in Table 4.3 revealed whether the gender of the entrepreneur was significant in obtaining funding for the firm or not. From the findings, males tended to be successful in obtaining funding for their firms than females, $\chi^2(1) = 5.177$, p-value = 0.023. However according to Table 4.4, age does not have a significant association with success in obtaining funding, $\chi^2(1) = 6.029$, p-value = 0.197.

Table 4.4: Association between age and success in obtaining funding

		Successful	Not successful	Total	χ^2	df	p- value
Age	18 to 24	0	0	0	6.029	4	0.197
	25 to 34	13	12	25			
	35 to 44	22	24	46			
	45 to 54	18	19	37			
	55 to 64	6	0	6			
	Total	63	59	122			

The findings in Table 4.5 revealed that the age of the entrepreneur was not related to their success in obtaining funding or not, $\chi^2(4) = 6.029$, p-value = 0.197. Table 4.5 presented the findings on the association between education and success in obtaining funding.

Table 4.5: Association between education and success in obtaining funding

		Successful	Not successful	Total	χ^2 Value	df	p- value
Highest Education Level	Secondary	5	0	5	7.608	3	0.055
	Tertiary	36	22	58			
	University	22	32	54			
	Vocational	0	5	5			
	Total	63	59	122			

The findings in Table 4.5 revealed that the age of the entrepreneur was not related to their success in obtaining funding or not, $\chi^2(4) = 6.029$, p-value = 0.197. Table 4.5 presented the findings on the association between education and success in obtaining funding.

Table 4.6: Association between relation to business and success in obtaining funding

		Successful	Not successful	Total	χ^2 Value	df	p- value
Relation to Business	Owner	15	35	50	15.886	2	0.000
	Manager						
	Partner	8	4	8			
	Director	40	20	60			
	Total	63	59	122			

From Table 4.6, the findings revealed that directors of the firms were more successful in obtaining funding than those with other relations to the business, $\chi^2(2) = 15.886$, p-value ≤ 0.001 .

4.3 Firm characteristics

The study sought to establish the firm characteristics and later on establish how they are related to the level of access to finance. The findings were summarized and presented in Table 4.7, Table 4.8, Table 4.9 and Figure 4.1 and Figure 4.2.

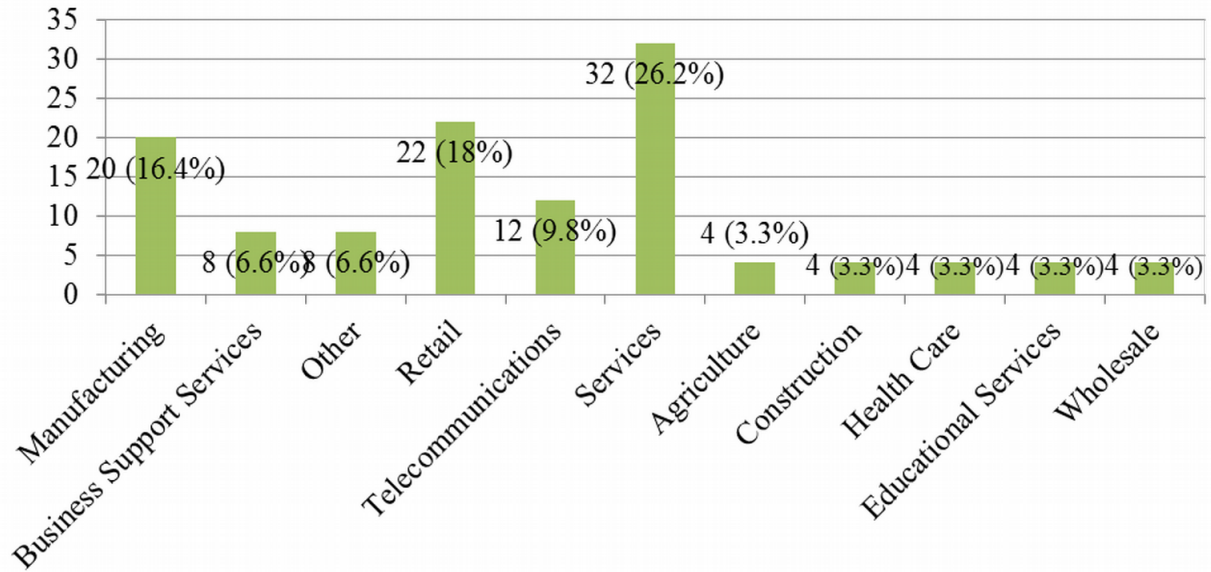


Figure 4.1: Economic sector

From the findings on the structure of the business, majority of the respondents, 53 (43.4%) were sole proprietorships while 53 (43.4%) were limited liability businesses. Partnerships as well as other structures comprised 13.6% of the total business structures. Furthermore, from Figure 4.1, the findings revealed the majority of the businesses, 32 (26.2%) were involved in the services sector followed by retail businesses, 22 (18%) and manufacturing, 20 (16.4%). Sectors such as agriculture, construction, health care, educational services and wholesale comprised only 4 (3.3%) each. Also, telecommunications were also notable at 9.8% representation.

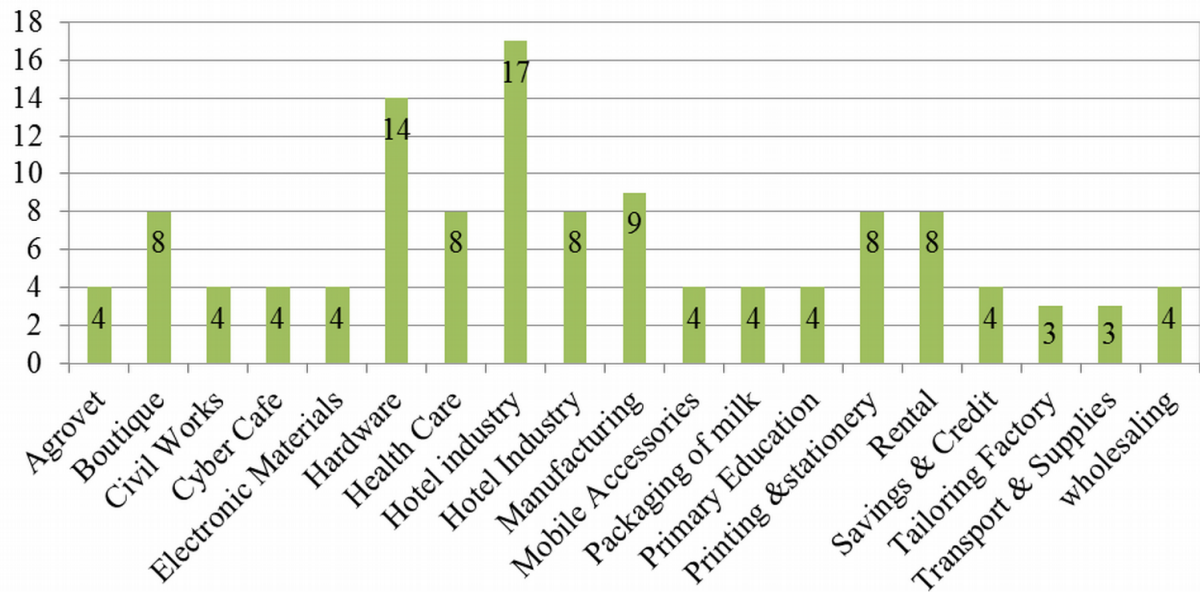


Figure 4.2: Main business activity

The findings in Figure 4.2 revealed that the main business activity for majority of the businesses, 17 (13.9%) were hotel businesses while 14 (11.5%) were hardware. This confirms the findings in Figure 4.1 which showed majority of the businesses were involved in the services sector. The study also sought to assess the firm characteristics related to the age of the firm, the stage the business was in at the time of the study, the number of employees in the firm which would essentially determine the size of the firm, the average turnover annually and the plan for the business over the next two years which would determine their potential for growth. These characteristics would also be measured against the ability of the firm to attract financial support from banks. The findings regarding this were summarized and presented in Table 4.7, Table 4.8 and Table 4.9.

Table 4.7: Number of years the business has been in operation since formation

Number of years the business has been in operation since formation		
Mean		8.39
Median		6
Percentiles	25	5
	50	6
	75	10

The findings in Table 4.7 were related to the age of the business in terms of the number of years the business had been in operation since start-up. The findings revealed

that majority of the businesses had been in operation for an average of 8.39 years (IQR [5-10]) with 75% of the businesses running for 10 years and 25% of them running for 5 years. Given this result, majority of the business were still young and in their infancy stages.

Table 4.8: Stage of business

Stage of Business	Frequency	Percent
Pre-start up (About to start operations)	5	4.1
Start up	24	19.7
Young	30	24.6
Established- Between 2yrs and 10 years	39	32
Old - Above 10 years	24	19.7
Total	122	100

Table 4.9: Number of employees, average turnover and plans

People Employed	Frequency	Percent
1 to 50	94	77
50 to 200	16	13.1
Other	12	9.8
Total	122	100
Average Annual Turnover	Frequency	Percent
Kshs. 500,000/= to 5m	70	57.4
Kshs. 5m to 100m	52	42.6
Total	122	100
Plans Next 2years	Frequency	Percent
Grow the Business Modestly	37	30.3
Grow Substantially	71	58.2
Maintain Current Level	14	11.5
Total	122	100

The findings in Table 4.9 revealed the majority of the businesses, 94 (77%) had employed 10 to 50 employees which confirms that majority of them were still young. In addition, majority of the businesses, 70 (57.4%) had an average turnover of between Kshs. 500,000 to Kshs. 5,000,000/= annually which also indicated infancy in terms of growth. These findings also highlight to some extent that the businesses were facing challenges and this was being reflected in their level of growth and access to finances might be one of the challenges. Finally, Table 4.49 revealed that majority of the businesses, 71 (58.2%) had a plan to grow substantially over the next 2 years which highlighted the need for access to vital financial support to enable expansion of their operations and business portfolio. A χ^2 test of independence was used to compare the frequency of success of obtaining funding for their businesses between different independent firm related factors

such as structure of the business, economic sector, stage of the business, number of people employed and the average turnover of the business. The findings were summarized and presented in Table 4.10, Table 4.11, Table 4.12 and Table 4.13.

Table 4.10: Structure of business and obtaining funding

		Whether the firm obtained funding			χ^2 Value	df	P-value
		Successful	Not successful	Total			
Structure of Business	Sole Proprietorship	15	35	50	23.482	3	0.000
	Limited Liability	37	16	53			
	Partnership	11	4	15			
	Other	0	0	0			
	Total	63	59	122			

The findings in Table 4.10 revealed the structure of the business, economic sector and the average turnover were significantly related to whether the entrepreneur obtained funding for the firm or not. From the findings, limited liability firms tended to be successful in obtaining funding for their firms than females, $\chi^2(3) = 23.482$, p-value ≤ 0.001 .

Table 4.11: Economic sector and obtaining funding

		Successful	Not successful	Total	χ^2 Value	df	P-value
		Economic Sector	Manufacturing	16	<5	20	60.042
Business Support Services	<5		8	8			
Other	8		<5	8			
Retail	7		15	22			
Telecommunications	<5		12	12			
Services	20		12	32			
Agriculture	<5		<5	<5			
Construction	<5		<5	<5			
Health Care	<5		<5	<5			
Educational Services	<5		<5	<5			
Wholesale	<5		<5	<5			
Total	63		59	122			

The businesses that particularly engaged in services sector and manufacturing sector tended to be successful in obtaining funding than businesses in other economic sectors, $\chi^2(10) = 60.042$, p-value ≤ 0.001 while those with an average turnover between Kshs. 5million and 100 million tended to be successful in obtaining funding than those with lower average turnover, $\chi^2(1) = 11.230$, p-value = 0.001. On the other hand, although

the findings showed that businesses which had been established between 2 years and 10 years ago formed the majority of the businesses assessed, generally, the stage of the business was not related to the success of obtaining funding, $\chi^2(4) = 3.580$, p-value > 0.05 as shown in Table 4.12.

Table 4.12: Stage of business and obtaining funding

		Successful	Not successful	Total	χ^2 Value	df	P-value
Stage of Business	Pre-start up	<5	<5	5	3.580	4	0.466
	Start up	11	13	24			
	Young	12	18	30			
	Established- Between 2yrs and 10 years	22	17	39			
	Old - Above 10 years	15	9	24			
	Total	63	59	122			

In addition, the findings in Table 4.13 revealed that although majority of the businesses (48) that had employed between 10 to 50 employees had been successful in obtaining funding, it was also shown that 46 of the businesses that had employed 10 to 50 employees were not successful in obtaining funding. This meant that, the number of people employed was generally not related to the business obtaining funding or not, $\chi^2(2) = 3.498$, p-value > 0.001 .

Table 4.13: People employed, average turnover and obtaining funding

		Successful	Not successful	Total	χ^2 Value	df	P-value
People Employed	10 to 50	48	46	94	3.498	2	0.174
	50 to 200	11	5	16			
	Other	<5	8	12			
	Total	63	59	122			
		Successful	Not successful	Total	χ^2 Value	df	P-value
Average Turnover	Kshs 500,000/= to 5m	27	43	70	11.230	1	0.001
	5m to 100m	36	16	52			
	Total	63	59	122			

4.4 Type of financing

The study also sought to establish the type of financing that was available to the businesses. This would aid in establishing the financial needs of the businesses and hence

assess the availability of financial needs. The findings were summarized and presented in Table 4.14.

Table 4.14: Funding

Funding for growth	Frequency	Percent
Internal finance Only	29	23.8
External finance only	16	13.1
Both internal and external	77	63.1
Total	122	100
Gender	Frequency	Percent
Male	93	76.2
Female	29	23.8
Total	122	100
Professional advisor type	Frequency	Percent
Auditor	22	18
Accountant	8	6.6
Lawyer	23	18.9
Trade Association	8	6.6
Consultant	16	13.1
None	41	33.6
Other	4	3.3
Total	122	100

The findings were in relation to the type of funding for growth and the type of professional advisor. From the findings in Table 4.14, it was revealed that majority of the businesses, 77 (63.1%) received both internal and external funding for growth. Furthermore, majority of the businesses, 41 (33.6%) did not access any form of professional advice in terms of access to funding for growth although, 18.9%, 18% and 13.1% sought lawyers, auditors and consultants respectively in terms of advice on financial access. The study also sought to establish whether the businesses had tried to obtain financial access in the last 12 months, the reasons for not trying, the reasons for not seeking funding and the preferred source of funding. The findings from this assessment would aid in establishing the barriers to accessing finance from the perspective of the entrepreneur as well as determining the best sources of funding for the businesses. The findings were summarized and presented in Table 4.15 and Table 4.16.

Table 4.15: Obtaining funding and reasons

Tried Obtaining Finance in the last 12 months	Frequency	Percent
Yes	46	37.7
Yes More than once	30	24.6
No	46	37.7
Total	122	100
Reasons for not Trying	Frequency	Percent
Complex application process	15	12.3
Too many forms to fill	2	1.6
Lack of collateral/security	25	20.5
Other	42	34.4
Total	122	100

From the findings in Table 4.15, it was revealed that 46 (37.7%) of the respondents had tried to access funding in the last 12 months while 30 (24.6%) had tried to access funding more than once. Of great concern was the finding that 46 (37.7%) of the entrepreneurs did not try to seek for funding in the last 12 months. The findings also revealed that for those who did not seek funding in the last 12 months, the main reason for 25 (20.5%) of the respondents was that they lacked collateral or security while 15 (12.3%) experienced complex application processes. From the findings, it was clear that although there are a significant number of those who had tried to seek funding in the last 12 months, the number of those who did not was also significant and the main reasons were lack of collateral and complex application processes. This provides and means through which stakeholders can engage with the businesses to enhance their level of access to funding by providing tailor-made solutions that would lessen or remove the barrier of the collateral as well as making the application process easier.

Table 4.16: Reasons for seeking funding and source of funding

Reasons for seeking funding	Frequency	Percent
Working capital	58	47.5
Capital expenditure	4	3.3
Buying another business	4	3.3
Marketing	4	3.3
Business growth	48	39.3
Other	4	3.3
Total	122	100
Preferred source of finance	Frequency	Percent
Bank loan	84	68.9
Bank overdraft	14	11.5
Leasing or hire purchase	4	3.3
Mortgage	12	9.8
Loan from family and friends	4	3.3
Credit from suppliers	4	3.3
Total	122	100

According to Table 4.16, majority of the businesses, 58 (47.5%) sought funding to enhance their working capital while 48 (39.3%) sought funding because of business growth. The findings in Table 4.6 also revealed that majority of the firms, 84 (68.9%) preferred bank loans as a source of finance. Other preferred sources were bank overdrafts and mortgages. The findings also showed that although the businesses also accessed other sources of funding, leasing or hire purchase, loan from family and friends and credit from suppliers only comprised 3.3% of the preferred sources of funding.

4.5 Level of obtaining funding

The study also sought to establish the level of access to funding in terms of the difficulties encountered in accessing funding and the experiences in getting the funding. The findings were summarized and presented in Table 4.17. These findings would enable assessment of the level of access to funding as the dependent factor and this would later be assessed in terms of the factors that determine the level of access to funding.

Table 4.17: Level of obtaining funding

Encountered difficulties of getting funded?	Frequency	Percent
Yes-unable to obtain funding	30	24.6
Yes- Obtained less than required	34	27.9
Yes-Obtained but with some problems	34	27.9
No difficulties	24	19.7
Total	122	100
What did you experience in getting finance?	Frequency	Percent
Surrendered early in the process	8	6.6
Withdrew halfway in the process	19	15.6
Completed the process but unsuccessful	32	26.2
Successful	63	51.6
Total	122	100

The findings in Table 4.17 revealed that 34 (27.9%) of the respondents experienced difficulties in getting funding because they obtained less than the required amount while others obtained the funding but with some problems. The findings also revealed that 30 (24.6%) noted that they were not able to obtain funding while 19.7% experienced no difficulties. These findings revealed that although over 80% of the respondents were able to access funding, there were problems experienced in terms of getting less than the required funding, getting the funding but with some challenges as well as not getting funding at all. The findings also revealed that 63 (51.6%) of the respondents were successful in terms of their experience in getting funded, 32 (26.2%) of the respondents completed the process but were unsuccessful in getting funded, 19 (15.6%) withdrew halfway in the application process while 6.6% of the respondents surrendered early in the process. The findings show that although slightly over 50% of the businesses were successful in getting funding, 48.4% were not successful because of various reasons key among them being that they were able to complete the process but were unsuccessful.

4.6 Challenges in obtaining funding

Basing on the findings on the level and experience of getting funding, the study also sought to determine the reasons for not getting the funding that they needed. The findings were summarized and presented in Figure 4.3.

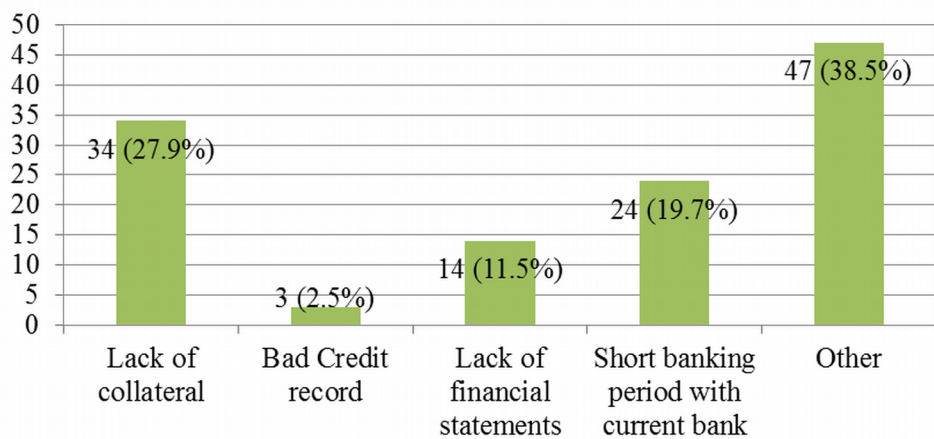


Figure 4.3: Reasons for non-funding

The findings in Figure 4.3 revealed that 34 (27.9%) were denied funding because of the lack of collateral, 24 (19.7%) did not obtain funding because of a short banking period with the current bank. Other notable reasons were the lack of financial statements for 11.5% of the businesses and bad credit record for 2.5% of the businesses. From these findings, it was clear that majority of the businesses, because of the fact that many were still in the establishment phase and had been in operation for approximately 8 years, they had short banking periods with their banks and did not have financial statements and given that majority of the businesses were not well established, they lacked collateral while some had a bad credit record which meant that they were not prudent in servicing their loans in the past and this had an impact on their ability to access funding later.

4.7 Impact of non-funding

The study further sought to determine the effect on the business as a result of not obtaining the funding that they required. The findings regarding this were summarized and presented in Figure 4.4.

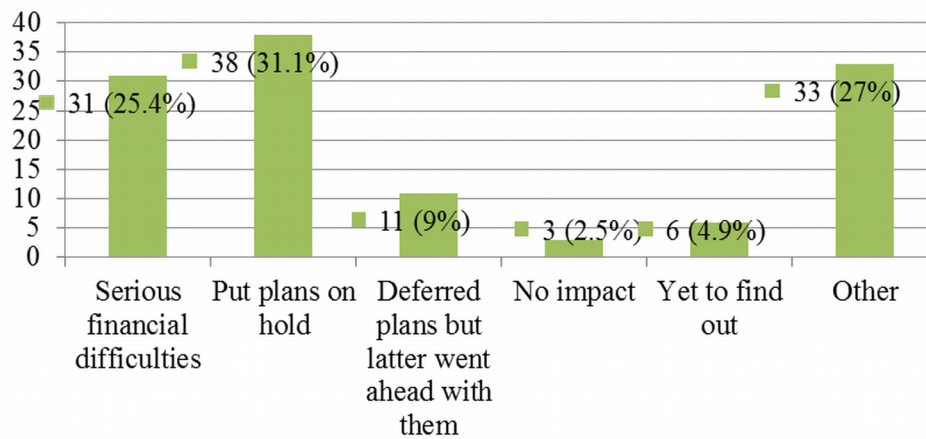


Figure 4.4: Impact of non-funding

The findings revealed that 38 (31.1%) revealed that their plans were put on hold as a result of non-funding, 31 (25.4%) experienced serious financial difficulties as a result of non-funding, 11 (9%) deferred their plans but later went ahead with them. The findings clearly revealed that there were profound consequences of non-funding which would ideally affect the business in terms of growth and the cycle would go on because as a result of poor firm performance, the propensity of the business to attract funding is lowered and this results in low levels of performance and this means that majority of the businesses were not profitable. In order to assess the influence of the independent factors on the propensity of the business to obtain funding for the business or not, odds ratios were computed. The odds ratio is the probability of an event happening divided by the probability of the event not happening. The odds ratio is such that if the χ^2 is significant, the odds ratio is also statistically significant. However, while the χ^2 informs whether there is a difference, the odds ratio informs on how big or strong the difference is.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of findings, conclusion, recommendations and further research recommendations that are deemed important for the extension of the research on the subject matter. This chapter discusses the findings in relation to research objectives and the propositions. A summary and overview of the research is then presented, followed by the shortcomings of the study, recommendations and additional research opportunities will be identified. Within the context of SME financial support, it is clear from the study that the primary issue at hand evolves as the access to financial resources. This is a problem common to many countries in the GEM scope of analysis, with the evidence suggesting that entrepreneurs across the globe find it difficult to secure formal financing for new venture creation unless they have collateral or some other form of credit history which serves to mitigate the inherent risk in starting a new business. The importance of SMEs to the economy expresses itself in their contribution to the GDP and employment which is likely to be as high as the large enterprises' contribution. With the current context of negative growth in employment creation by both large enterprises and the government sector, SMEs have a major socio-economic role to play as already shown in the study. However, this objective fails to materialize due to the high failure rate of small businesses in Kenya. A major factor attributed to this high failure rate pertains to the lack of access to finance especially at start-up phase as shown in the study. However, as portrayed in the literature study in chapter three, it has been shown that entrepreneurs across GEM universe are heavily reliant on their own savings or friends and family for start-up finance (Orford et al., 2003). This study endeavored primarily to create a platform from which further research can be conducted. It has evaluated the current position with respect to problems of accessing SME finance in Kenya. Expectantly the study will assist potential entrepreneurs, academics, SME support agencies, government, SME organizations and

funding institutions to understand the problems of accessing SME finance.

5.2 Summary and discussion of findings

5.2.1 Effects of entrepreneur characteristics on access to bank finance

The findings of the study showed that majority of the entrepreneurs were males. In addition, majority of the respondents are aged between 35 to 44 years followed by those between 45 to 54 years. Furthermore, majority of the entrepreneurs had attained tertiary education (this was mainly those who attained tertiary colleges which mainly offer diploma certificate courses) and university education. The findings also revealed that majority of the respondents were directors and managers of the businesses. Studies have shown that female applicants are viewed as more risk averse than male applicants. Furthermore, directors of the firms were more successful in obtaining funding than those with other relations to the business, $\chi^2(2) = 15.886$, p-value ≤ 0.001 . Also, the property ownership in the African family set-up favors men over women. In addition, Verheul and Thurik (2001) found that although men and women do not significantly differ in terms of the type of capital, female SME owners appear to have a smaller amount of start-up capital and face more credibility issues when dealing with bankers (Badulescu, 2011). Mijid (2009) also found higher loan denial rates and lower loan application rates among female entrepreneurs. From the findings, males tended to be successful in obtaining funding for their firms than females, $\chi^2(1) = 5.177$, p-value = 0.023. In terms of age, studies have shown that the personal financing preferences of entrepreneurs appear to change according to age. However, age does not have a significant association with success in obtaining funding, $\chi^2(1) = 6.029$, p-value = 0.197. When the level of education was assessed, the findings were in line with Coleman (2007) notes that the educational background of the SME owner–manager is often positively related to the firms usage of leverage. The findings have however revealed that the age of the entrepreneur was not related to their success in obtaining funding or not, $\chi^2(4) = 6.029$, p-value = 0.197. This can be partly because of the diversity in terms of business innovation and the potential for growth where younger entrepreneurs can outperform the older ones and the opposite might also hold. The findings in Table 4.5 revealed that the age of the entrepreneur was not related to

their success in obtaining funding or not, $\chi^2(4) = 6.029$, p-value = 0.197. From Table 4.6, the findings revealed that directors of the firms were more successful in obtaining funding than those with other relations to the business, $\chi^2(2) = 15.886$, p-value ≤ 0.001 .

5.2.2 Effects of firm characteristics on access to finance

From the findings on the structure of the business, majority of the businesses were sole proprietorships followed by those that were limited liability businesses. Partnerships as well as other structures comprised 15.6% of the total business structures. The findings also revealed that majority of the businesses were mainly involved in the services sector followed by retail businesses and manufacturing. Sectors such as agriculture, construction, health care, educational services and wholesale comprised only 3.3% each. In addition, telecommunications were also notably represented. The findings also revealed that the main business activity for majority of the businesses were hotels followed by hardware businesses. These findings clearly indicate that SMEs represent majority of informal businesses (Gumede, 2000; Berry et al., 2002). As such SMEs contribute to a country's GDP in two ways-by either manufacturing goods of value, or through the provision of services to both consumers and/or other enterprises. This encompasses the provision of products and, to a lesser extent, services to foreign clients, thereby contributing to overall export performance. The findings related to the age of the business in terms of the number of years the business had been in operation since start-up showed that majority of the businesses had been in operation for an average of 8.39 years (IQR [5-10]). In terms of experience, Coleman (2007) found that experience also enhances the availability of credit. Nofsinger and Wang (2011) posit that the experience of the entrepreneur is one factor that explains the difference in external financing levels available to SMEs. The findings of the study proved this hypothesis. The findings also revealed that majority of the businesses employed 10 to 50 employees which confirms that majority of them were small and medium enterprises. In addition, majority of them had an average turnover of between Kshs. 500,000 to Kshs. 5,000,000 annually which also indicated infancy in terms of growth. Finally, it was revealed that majority of the businesses, had a plan to grow substantially over the next 2 years.

5.2.3 Type of financing difficulties faced in obtaining finance and their impact on business and growth plans

These findings are in line with those of Stella (2011) who notes that despite the important contribution to economic growth by SMEs they continue to face numerous challenges including; inadequate infrastructural facilities, challenges with attracting skilled manpower, high rate of enterprise mortality, lack of a facilitative operating environment, restricted market access, and onerous regulatory requirements. However, one of the main areas of concern is access to funding. In addition, the size of the firm in terms of turnover and number of employees was in line with the definition of SMEs as those that have 1-10 number of employees with a turnover of Kshs 0-5million, small enterprise 11-50 employees with turnover of Kshs 5-50m million and Medium enterprises has 51-100 employees and turnover of Kshs 51 million-1 billion. The findings with regard to the type of funding for growth and the type of professional advisor showed that majority of the businesses received both internal and external funding for growth. Furthermore, majority of them did not access any form of professional advice in terms of access to funding for growth although, 18.9%, 18% and 13.1% sought lawyers, auditors and consultants respectively in terms of advice on financial access. From the findings it was also revealed that there were businesses that had tried to access funding in the last 12 months with 24.6% of them having tried to access funding more than once. There was great concern with 37.7% of the entrepreneurs who did not try to seek for funding in the last 12 months. The findings also revealed that the main reason for those who did not seek funding in the last 12 months was that they lacked collateral or security and complex application processes. Majority of the businesses had sought funding to enhance their working capital and for business growth. The findings also revealed that majority of the firms preferred bank loans as a source of funding. Other preferred sources were bank overdrafts and mortgages. The findings also showed that although the businesses also accessed other sources of funding, leasing or hire purchase, loan from family and friends and credit from suppliers only comprised 3.3% of the preferred sources of funding. Clearly, majority of the firms relied heavily on the traditional sources of funding. Stella (2011) asserts that there comes a time for all developing SMEs when they need new investments to expand or innovate further because the level

of access to funding and the high cost of finance through the traditional channels have been major constraints to SMEs hence the need to explore alternatives. Access to finance is the lifeline of any enterprise to enable it to grow and to generate more output and employment creation. The theoretical recognition that financing gaps will always exist in the financial markets can be traced to a study by Stiglitz and Weiss (1981). In addition, Stella (2011) notes that SMEs require adequate financing to meet needs at each stage of their life cycle, from creation through operation, development, expansion, and beyond. Financing is necessary to help them set up and enhance their operations, develop new products, and invest in new staff or production facilities. The findings also revealed that 27.9% of the businesses experienced difficulties in getting funding because they obtained less than the required amount while others obtained the funding but with some problems. The findings also revealed that although over 80% of the respondents were able to access funding, there were problems experienced in terms of getting less than the required funding, getting the funding but with some challenges as well as not getting funding at all. With this situation, in most transition economies, SME access constraint is cited as one of the greatest obstacles to increasing business activities and growth (Nam, 2006). The findings also revealed that although slightly over 50% of the businesses were successful in getting funding, 48.4% were not successful because of various reasons key among them being that they were able to complete the process but were unsuccessful. The findings also revealed that the firms that were not able to obtain funding were denied funding because of the lack of collateral, a short banking period with the current bank, lack of financial statements and bad credit record. Furthermore, the findings also revealed that over 30% of the firms put their plans on hold as a result of non-funding, over a quarter experienced serious financial difficulties as a result of non-funding while almost 10% deferred their plans but later went ahead with them.

5.3 Conclusion

Unleashing the growth potential of the SME sector is often seen as a solution to Kenya's job crisis and a means of increasing the growth rate. However, government's efforts to support the sector have so far been dismal. As shown by the study there is a high failure

rate for small business mainly due to lack of access to finance to start-up and expand businesses. What is needed is an entirely new approach. Rather than overemphasizing costly interventions to support small enterprises, the state should focus on eliminating the barriers created by excessive regulation and the absence of effective markets. Although government has tried to put in place policies and institutions with an aim of improving the accessing of finance by small business owners, their success has been minimal. It is therefore imperative that management capability and financial management acumen be regarded as key to easy access for funding by the entrepreneurs themselves, and the parties involved in supporting and promoting them.

5.4 Recommendations

Management capability strengthens the financial capacity of SMEs. Lenders are prone to be favorably biased towards SMEs who can demonstrate eloquence in areas such as financial management (including basic book keeping), marketing and technology upgrading. It is therefore recommended that government and other service providers incorporate additional simplified components to their training packages to cover such areas as bookkeeping and compilation of business plans. Educational background of entrepreneurs also has a direct influence in how they respond to training. From the interview with the lenders, it was noted that funding institutions regard at least some basic management and financial grounding within entrepreneurs as a guarantee that their funds will be utilized profitably resulting in the growth of SMEs. Also, more non-financial services, better tailored to the needs of financial intermediaries should be put in place so as to facilitate greater access to debt and equity finance for entrepreneurs. Specialized capacity building support (training, workshops, and conferences) should be provided in areas such as individual lending methodologies for small scale and start-up equity investments for equity financiers. From the study it was noted that the banking system requires some security and collateral because banks do not see these entrepreneurs as investors. For someone without assets, it is impossible to get a loan. Also, financial contracts and collateral laws should be revised so as to facilitate the registration and realization of collateral. Financial institutions should make financial contributions to non-financial support services such as provision of

financial management skills and mentoring. An environment should be created to allow a far greater level of competition between banks, as well as between banks and non-bank financial service providers, in the provision of financial services and particularly debt finance to SMEs. Access to information about SMEs should be increased to ensure that all providers and potential providers of finance have a sufficient knowledge to assess the risk of SME applications for finance. Any intervention that improves the ability of financial providers to accurately assess risk would increase their willingness to extend credit and other financial services to SMEs. Funding institutions should advertise their services so that the entrepreneurs are aware of where to go when they need money to start-up or grow their businesses. From the results of the study, it was noted that bad credit record is one of the obstacles in the accessing of small business finance by entrepreneurs. Therefore, it is recommended that there should be an improved regulation of credit bureau in order to enhance their credibility and the integrity of the information being distributed by the credit bureau.

5.5 Recommendations for Further Research

Further research that can be conducted includes the following:

- i. The view of financing institutions on why small SME entrepreneurs fail to secure finance from formal institutions. Further research could be conducted on the reasons why banks reject most of the applications for finance submitted by entrepreneurs.
- ii. Certain skills are a pre-requisite for a successful application for finance such as book-keeping, cash flow management and drafting of comprehensive business plan. Further research could be conducted into how banks/government could impart these skills to the potential entrepreneur.

Further research can also be conducted to determine what strategic alternatives can be implemented to assist SMEs in their endeavors.

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APPENDIX 1: QUESTIONNAIRE

Dear Respondent,
My name is Kili Muhindi Rop and I wish to thank you for your participation in this survey. This survey and the responses you give are solely and purely for academic purposes only. This questionnaire is for the purpose of carrying out an academic research on the **CONSTRAINTS FACED BY SMES GENERALLY AND IN ELDORET TOWN IN PARTICULAR ACCESSING BANK FINANCING**. Please do not write your name or name of your tea firm on this questionnaire. Kindly, give your opinion by typing (A) or marking √ inside the bracket/ box appropriately.

Thank you

Sincerely,

.....

A. ENTREPRENEUR CHARACTERISTICS

This section seeks information of the entrepreneur

1. What is your gender?
Male []
Female []

2. What is your age bracket (years)?
18 – 24 []
25 – 34 []
35 – 44 []
45 – 54 []
55 – 64 []
65+ []

3. What is your highest educational level?
Secondary []
Tertiary institution []
University []
Vocational training []

4. What is your relation to the business?
Owner []
Partner []
Director []
Other [] (please specify)

5. What is the form of the business?
Sole proprietorship []
Limited liability []
Partnership []
Other [] (please specify)

6. Which sector does your business belong?
- | | | | |
|--------------------|--------------------------|---------------------------|---|
| Manufacturing | <input type="checkbox"/> | Finance | <input type="checkbox"/> |
| Retail | <input type="checkbox"/> | Healthcare | <input type="checkbox"/> |
| Telecommunications | <input type="checkbox"/> | Educational services | <input type="checkbox"/> |
| Services | <input type="checkbox"/> | Wholesale | <input type="checkbox"/> |
| Agriculture | <input type="checkbox"/> | Business support services | <input type="checkbox"/> |
| Construction | <input type="checkbox"/> | Other | <input type="checkbox"/> (please specify) |

7. Briefly explain the main activity of your business?

8. When was the business started?

9. In terms of development, at which stage would you say the business is?
- | | |
|--|--------------------------|
| Pre-start up (not yet trading) | <input type="checkbox"/> |
| Start up Early stage (about 6 months old) | <input type="checkbox"/> |
| Young (1 to 2 years old) | <input type="checkbox"/> |
| Established (More than 2 years old but less than 10) | <input type="checkbox"/> |
| Old (More than 10 years old) | <input type="checkbox"/> |

B. BUSINESS DEMOGRAPHICS

10. How many people do you employ? (Including owners, directors and casuals)
- | | |
|--------------------------------|---|
| More than 10 but less than 50 | <input type="checkbox"/> |
| More than 50 but less than 200 | <input type="checkbox"/> |
| Other | <input type="checkbox"/> (please specify) |

11. What is your average turnover per year?
- | | |
|---|--------------------------|
| More than Kshs. 500,000 but less than Kshs. 5 million | <input type="checkbox"/> |
| More than Kshs. 5 million but less than 100 million | <input type="checkbox"/> |

12. Over the next 2 years, do you plan to ...?
- | | |
|--|---|
| Grow the business modestly | <input type="checkbox"/> |
| Grow the business substantially | <input type="checkbox"/> |
| Maintain the business at current level | <input type="checkbox"/> |
| Scale down the business from current level | <input type="checkbox"/> |
| Sell, transfer or wind up the business | <input type="checkbox"/> |
| Other | <input type="checkbox"/> (please specify) |

13. If planning to grow the business, do you expect to fund your growth with ...?
- | | |
|----------------------------|---|
| Internal finance only | <input type="checkbox"/> |
| External finance only | <input type="checkbox"/> |
| Both internal and external | <input type="checkbox"/> |
| Other | <input type="checkbox"/> (please specify) |

14. Which of the following external support are helping you obtain finance if any

- Auditor []
- Accountant []
- Lawyer []
- Trade Association []
- Consultant []
- None []
- Other [] (please specify)

15. In the last 12 months, have tried obtaining finance for your business?

- Yes- once []
- Yes- more than once []
- No []

16. If you answered No in question above, indicate the reason why you have not tried to obtain finance

- Complex application process []
- Too many forms to fill []
- Lack of collateral/ security []
- Other [] (please specify)

C. SEEKING FINANCING

17. What were you seeking finance for if any?

- Working capital []
- Capital expenditure []
- Research and development []
- Buying another business []
- Marketing []
- Business growth []
- Training and staff development []
- Other [] (please specify)

18. Which of the following categories were your preferred sources of financing?

- Bank loan []
- Bank overdraft []
- Credit card []
- Leasing or hire purchase []
- Mortgage []
- Loan from family/ friends []
- Credit from suppliers []
- Factoring/ invoice discounting []
- Venture capital/ equity finance []
- Other [] (please specify)

D. DIFFICULTIES OBTAINING FINANCE

19. Thinking about your preferred type or source of financing, did you have any difficulties in getting funded from that type/ source?

- Yes- Unable to obtain finance required []
- Yes- Obtained less than required []
- Yes- Obtained finance but with some problems []