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Influence of Entrepreneur and Firm Characteristics in Accessing Bank finance

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Abstract

SMEs are mostly guided by the owners' characteristics which is an indicator of the level of decisions taken in the firm. Access to credit is a prerequisite for a high performance of an SME. The paper aimed at establishing the empirical link between entrepreneurs and firm characteristics and access to bank financing by SMEs in Eldoret town. Descriptive and explanatory research designs were employed in the study. A chi-square test of association was used to determine the relationship between study variables. The study findings indicated that gender and number of employees had a significant influence on access to bank financing. Male entrepreneurs are more likely to get bank financing compared to their female counterparts, while an increase in the number of employees increases the success rate of getting bank financing. However, age, education, business form, number of years of operation, stage of business and average turnover were found to be insignificant in obtaining funding. The study concluded that entrepreneur characteristics namely gender and relation to business and firm characteristics specifically structure of the business, economic sector and the average turnover determines the likelihood of banks financing SMEs. Entrepreneurial and firm characteristics were found to be important in access to bank financing. The study recommended that government and other service providers incorporate additional simplified components to their training packages to cover such areas as bookkeeping and development of business plans. Banks should develop lending policies which are friendly to Small and Medium Enterprise contexts.

Keywords: *Entrepreneur, firm characteristics, access, bank financing, SMEs*

1.0 Introduction

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 & Udell, 2004) yet to date it has not fully been answered. Small and Medium Enterprises (SMEs) have played and continue to play a major role in economic and social development the world over. According to Ayyagari et al., (2007) the contribution by SMEs to employment in the manufacturing sub-sector both in developed and developing economies is sixty per cent. Stella (2011) argues that SMEs are the main source of economic growth in developed and developing countries. 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 contribute about 40% to GDP (Stella, 2011). These examples demonstrate the SMEs integral role in the economy hence, critical in spurring socio-economic development (Stella, 2011).

The ongoing importance and contribution by SMEs has underscored the need for examining their access to bank financing which is a significant contributor to their growth. In many transitional economies, improved access to finance for firms is a driving force for growth. Business plays an important role in boosting and enhancing productivity. Beck, Demirguc-Kunt and Peria (2008) suggests that SMEs around the world are able to access formal financial resources through credit loans from banks, while Haas, Ferreira, and Taci (2010) equally confirm that effective banking systems help in supporting business which translates into economic growth. Lending from financial institutions to SMEs facilitates new growth for business ventures, which results in increased national growth rates (Beck et al., 2008; Rahaman, 2011). It is undeniable that banks give little attention to SMEs due to the 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 are most affected (Le et al., 2006). In the developing context where banks find it difficult in lending to SMEs under these circumstances tends to be of great concern, since they are often unreliable in disclosing necessary financial information which meets the bank's requirements. 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 is a constraint cited as one of the greatest obstacles to increasing business activities and realizing growth (Nam, 2006).

In order to respond to the urgent need for a country's growth and the aspiration, SME finance constraints should be overcome through government policies which will create a more favorable environment for banks to lend to SMEs. Access to finance is the lifeline of any enterprise for it to grow and to generate more output and create employment. The theoretical existence of financing gaps will always exist in the financial markets and can be traced to existing literature. Information asymmetry informs credit rationing in financial markets. Information asymmetry arises because borrowers have inside information which lenders do not have. Borrowers most times use this information asymmetry for their own benefit to the detriment of the lender. Hence lenders face challenges in discriminating between 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. Thus, before lending, banks usually conduct an appraisal process where they inquire or

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observe the entrepreneur and SMEs characteristics. The entrepreneur and SME characteristics are used to gauge and screen the borrower's ability to make good use of the credit and ability to repay the bank loan. Though financing is cited as a major constraint for SME growth, a survey of literature dealing with this matter suggests 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 by empirically analyzing the influence of the entrepreneur and firm characteristics on the access of bank financing.

1.1 Research Problem

Small and medium enterprises play an important role in the economic development of a country. Hence access to finance is important and attainable where the business environment is favourable and availability of business development services, the resultant effect is SME growth. There is limited research on the constraints faced by SMEs in accessing bank finance hence, there is limited understanding how entrepreneur and firm characteristics influence SME access to banks in Kenya. The problem of access 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 ensure that SMEs gain full benefit from the current trend towards a transformation into a market economy, it was crucial to identify issues confronting SMEs, and to evaluate their impact on operations. Therefore, this study aimed at establishing the empirical nexus between entrepreneur and SME characteristics and access to bank financing.

1.2 Research Objectives

i. To examine the relationship between the entrepreneurs' characteristics and access to bank finance.
ii. To analyze the effects of the firm characteristics on access to finance.

2.0 Literature Review

Relevant studies were reviewed on; gender and access to credit, age and access to credit, education level and access to credit, industry sector and access to credit, ownership structure and access to credit and size and age of the business and access to credit.

2.1 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) Verhuel and Thurik (2001) in their study 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 Spite of this perspective, enterprise literature suggests that differences in financing sources related to gender among SMEs is more highlighted during the introductory (start-up) stage. In addition, women-owned SMEs begin in business with less than half of the 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 as compared to their male counterparts. Coleman (2007) provides evidence on 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. The gender differentials in access to finance can be categorized into discrimination, abilities preferences, and competition (Harrison & Mason, 2007). Moreover, Verhuel and Thurik (2001) divided the impact of gender on SMEs capital into direct and indirect effects. 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 yet to be tested within the Kenyan context. In line with previous literature, this study hypothesized that gender has a significant association with access to credit by SMEs in Eldoret CBD.

2.2 Age and Access to Credit

It is often found that personal financing preferences of entrepreneurs appear to change according to age. Romano et al. (2001), suggests that 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 owners–managers are more reluctant when it comes to accepting external ownership in the firm. Further, Vos et al. (2007) empirically established 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. this clarifies the connection between the financial growth cycle of SMEs and the owner–manager's life cycle, Briozzo and Vigier (2009) alludes 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). However, research on the influence of entrepreneur age and access to credit remains elusive in Kenya. Thus, this study hypothesized that entrepreneur age has significant association with access to credit by SMEs in Eldoret CBD.

2.3 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 and 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. Similarly, this study hypothesized that the education level of the entrepreneur has significant association with access to credit by SMEs in Eldoret CBD.

2.4 Industry Sector and Access to Credit

Existing literature provides evidence on the factors related to the industry sector in which a firm operates and also explains 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. 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. In that regard, this study hypothesized that the industry sector has significant association with access to credit by SMEs in Eldoret CBD.

2.5 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 a greater variety of financing alternatives than owners of firms organized other than a sole proprietorship of non-construction/manufacturing firms. 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 affects 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 credibility. Consequently, incorporated firms appear to be in a very favored position in receiving external funding in comparison with unincorporated firms. Thus, this study hypothesized that ownership structure has significant association with access to credit by SMEs in Eldoret CBD.

2.6 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 SMEs 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). Cassar (2004) found that the "larger" of the small firms rely more on long-term debt and external financing, including bank loans. Berger and Udell (2004) and 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. In regard to firm age, Quartey (2003) who concluded the significant positive effect of firm age on the ability to access external finance supports this. In

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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. Following this empirical evidence, this research hypothesized that firm size and age has significant association with access to credit by SMEs in Eldoret CBD.

3.0 Research Methodology

The target population of study comprised of registered SMEs in Eldoret Municipality. The study targeted approximately 8175 SMEs in Eldoret town. The SMEs comprised those in the manufacturing, finance and services sectors and were evenly spread across the CBD. Given that this is a cross-sectional data set; sometimes random sampling is not appropriate as an assumption for analyzing cross-sectional data because some entrepreneurs might choose not to participate in the research. Hence, the study used a purposeful method to choose the sample for study. A sample of 35 SMEs was sampled with 4 respondents randomly selected to raise a sample of 140 respondents. The study utilized primary data derived from structured questionnaires. The study used a chi-square test to test the degree of association between the independent and dependent variables (access to bank credit or finance).

4.0 Research Findings and Discussion

The section presents the discussion of the study findings.

Table 1 presents the summary statistics of the entrepreneur characteristics data.

Table 1: Summary Statistics of Entrepreneur Characteristics

Gender	**Frequency**	**Percent**
Male	90	73.8
Female	32	26.2
Age Bracket (years)		
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 65	6	4.9
Highest Education		
Secondary	8	6.6
Tertiary	58	47.5
University	54	44.3
Vocational	2	1.6
Relation to Business		
Owner Manager	50	41
Partner	12	9.8
Director	60	49.2

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The study results presented in Table 1 shows that the majority (90, 73.8%) of the respondents who own business in Eldoret town CBD were Male while the female represented 26,2%. Of the respondents most were in the age bracket of 35 to 44 years. The result on the educational level shows that the majority (91.8%) had a higher educational level. on ownership and operation of the enterprises most (49.2%) were directors of the enterprises. The results imply that male and middle aged people dominate the SMEs sector as compared to the female, younger and older entrepreneurs. These age groups are economically more active compared to other age groups. The results also show that most entrepreneurs have at least a tertiary and university level of education. 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. Furthermore, most of the respondents were the owners or managers of the SMEs giving indication that they control the operations and management of their business. Table 2 presents the association between entrepreneur characteristics and access to bank finance.

The association between entrepreneur characteristics and access to bank finance is summarized in Table 2.

Table 2: Entrepreneur Characteristics and Access to Bank Finance

		Successful	Not Successful	Total	$\chi2$	P value
Gender	Male	52	38	90	5.177	0.023
	Female	11	21	32		
Age	18 to 24	0	0	0	6.029	0.197
	25 to 34	13	12	0		
	35 to 44	22	24	25		
	45 to 54	18	19	46		
	55 to 65	6	0	37		
Highest Education Level	Secondary	5	0	5	7.608	0.055
	Tertiary	36	22	58		
	University	22	32	54		
	Vocational	0	5	5		
Relation to Business	Owner Manager	15	35	50	15.866	0.000
	Partner	8	4	12		
	Director	40	20	60		

The results in Table 2 show that gender has significant association with access to bank finance ($\chi2$ = 5.177, p-value = 0.023). The results imply that males (82.54%) tended to be more successful in obtaining funding for their firms in comparison to the females. Age does not have a significant association with success in obtaining funding ($\chi2$ = 6.029, p-value = 0.197). Similarly, education level does not have significant association with access to bank finance ($\chi2$ = 7.608, p-value = 0.055). Further results revealed that entrepreneur relation to business has significant association with access to bank finance ($\chi2$ = 15.866, p-value = 0.000). However, entrepreneurs who function as directors in their business are more likely to get bank finance access at 63% of the successful bank finance compared to entrepreneurs who function as partners or owner managers.

The results on firm characteristics are presented in Figure 1.

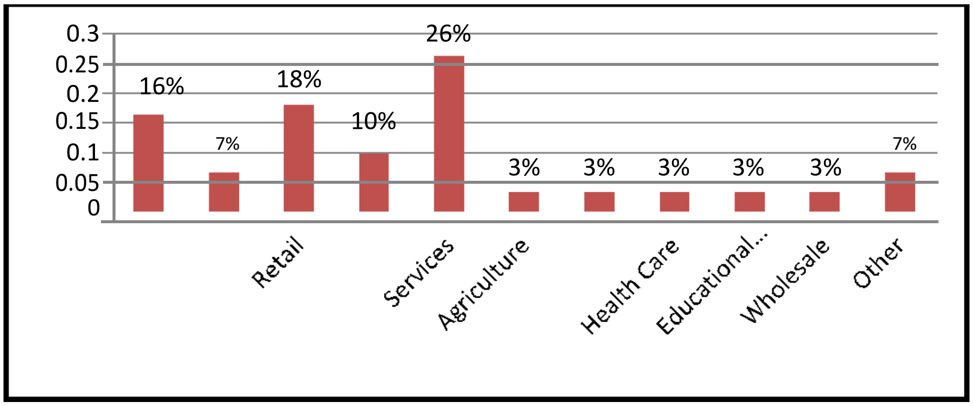

Figure 1: Business Sector

The results as present in Figure 1 reveal that most (26%) of the businesses were in the service sector. Sectors such as agriculture, construction, health care, educational services and wholesale comprised only 3%respectively. The results in Table 3 show firm characteristics in terms of the time that the business has been in operations, stage of business, people employed, average annual turnover and business plans in the next 2 years.

Table 3 Firm Characteristics Summary Statistics

	Mean	**Median**	**Percentile**
Years of operations	8.39	6	25^{th}(5), 50^{th}(6), 75^{th}(10)
Stage of Business	Frequency		Percentage
Pre-start up	5		4.1
Start-up	24		19.7
Young	30		24.6
Established (between 2 to 10 yrs)	39		32
Old (Above 10 yrs)	24		19.7
People Employed			
1 to 50	94		77
50 to 200	16		13.1

Other	12	9.8
Average Turnover		
Ksh 500,000 to 5m	70	57.4
Ksh 5m to 100m	52	42.6
Plans next 2 yrs		
Grow the business modestly	37	30.3
Grow Substantially	71	58.2
Maintain current level	14	11.5

As shown in Table 3 the 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 suggesting that most businesses were still young and in their infancy stages. Further, the majority of the businesses, 94 (77%) had employed 10 to 50 employees. In addition, the 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. 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. Table 4 shows the chi-square test of association between firm characteristics and access to bank financing. As shown in Table 3 the majority of the businesses had been in operation for an average of 8.39

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Table 4: Firm Characteristics and Access to Bank Finance

		Successful	Not Successful	Total	χ2	p.value
Structure of Business	Proprietorship	15	35	50	23.482	0.000
	Limited liability	37	16	53		
	Partnership	11	4	15		
	Other	0	0	0		
Economic sector	Manufacturing	16	<5	20	60.042	0.000
	Business support services	8	<5	8		
	Other	7	15	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 services	<5	<5	<5		
Stage of Business	Pre-start up	<5	<5	<5	3.580	0.466
	Start-up	11	13	24		
	Young	12	18	30		
	Established (between 2 to 10 yrs)	22	17	39		
	Old (Above 10 yrs)	15	9	24		
People Employed	1 to 50	48	46	94	3.498	0.174
	50 to 200	11	5	16		
	Other	<5	8	12		
Average Turnover	Ksh 500,000 to 5m	27	43	70	11.230	0.001
	Ksh 5m to 100m	36	16	52		

The results in Table 4 shows the structure of the business, economic sector and the average turnover had significant association with access of bank finance ($\chi2 = 23.482$, p-value = 0.000, $\chi2 = 60.042$, p-value = 0.000 and $\chi2 = 11.230$, p-value = 0.001 respectively). Limited liability business tends to be more successful in accessing bank finance compared to other structures of business, while business in manufacturing sector are more likely to get bank finance as compared to other types of business and firms with an average turnover of between Ksh. 5m to 100m are 57.14% more likely to get bank finance compared to firms with an average turnover of Ksh. 500,000 to 5 million.

5.0 Conclusion and Recommendations

The study concluded that entrepreneur characteristics namely gender and relation to business and firm characteristics specifically structure of the business, economic sector and the average turnover determines the likelihood of banks financing SMEs. Entrepreneurial and firm characteristics were found to be important in access to bank financing. This study therefore, particularly informs the lenders to SMEs on the key characteristics to consider in developing lending policies to SMEs. The study recommended that government and other service providers incorporate additional simplified components to their training packages to cover such areas as bookkeeping and development of business plans. Banks should develop lending policies which are friendly to Small and Medium Enterprise contexts.

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