

**FACTORS AFFECTING ACCESS TO CREDIT BY SMALL AND MEDIUM
ENTERPRISES IN MICROFINANCE INSTITUTIONS IN NAKURU
MUNICIPALITY, KENYA**

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Requirements for the Award of the Degree of Master of Business Administration of
Egerton University**

EGERTON UNIVERSITY

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DECLARATION AND RECOMMENDATION

This research project is my original work and has not been presented for any other award in any other institution of learning.

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DEDICATION

This work is dedicated to my husband Stephen Muhoro and children, Winfred Kirigo,
Christine Muthoni and Mark Muhoro

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This work would not have been completed with my effort alone. My most heartfelt gratitude goes to God for His provision, strength and enablement. I know if it were not for Him I would not have completed this project.

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May God bless and shine His face upon you all.

ABSTRACT

Microfinance can be seen as a supply of loans, savings and other financial services to the SMEs. Financial access can help firms start up and expand their businesses through *inter alia* development of new products and production processes, and investment in human capital. A variety of financial services (credit, savings, insurance, and payment facilities) are crucial for growth in the SME life cycle. This study therefore sought to evaluate factors affecting access of credit by small and medium enterprises in microfinance institutions. The specific research objectives included determining: the extent to which SMEs characteristics affect credit accessibility facilities offered by MFIs, the extent to which collateral of SMEs affects credit accessibility from MFIs and to evaluate whether credit policies of MFIs affect credit accessibility by SME. The study adopted cross-sectional survey design to achieve the objectives. The study employed a sample of 244 from a population of 620 SMEs located within Nakuru municipality. Primary data was collected from the study respondents using structured questionnaires administered by the researcher. Data was analyzed with the help of the Statistical Package for Social Sciences (SPSS) computer software. Both descriptive statistics (frequencies, means and percentages) as well inferential statistics (correlation and regression analysis) were used analyze to test the relationship between independent variables (factors affecting access to credit) and dependent variable (Access to credit). From the results of data analysis it was concluded that although the SMEs characteristics had the capability to positively affect access to credit by SMEs, they were yet to be fully utilized to the advantage of the SMEs in the study area. The MFIs requirements and credit policies negatively and significantly influenced access to credit offered by the MFIs in the study area. The study recommends that: the MFIs should seek to transform some of the critical characteristics of SMEs such as size, industry sector and location to their advantage in order to enable SMEs increase access to credit; endeavour to understand and meet the SMEs requirements for credit such as helping them in preparing financial statements and credit scoring and MFIS should address the various credit policies such as lack of training, collateral, past lending history and cost of lending in order to increase SMES access to credit through capacity building.

TABLE OF CONTENTS

DECLARATION AND RECOMMENDATION	ii
COPYRIGHT	iii
ACKNOWLEDGEMENT	v
ABSTRACT	vi
TABLE OF CONTENTS	vii
LIST OF TABLES	x
LIST OF FIGURES	xi
LIST OF ABBREVIATIONS AND ACRONYMS	xii
CHAPTER ONE	1
INTRODUCTION.....	1
1.1 Background of the Study	1
1.2 Statement of the Problem.....	4
1.3 Purpose of the Study	4
1.4 Research Objectives.....	4
1.5 Research Hypotheses	4
1.6 Significance of the Study	4
1.7 Scope of the Study	5
1.8 Limitations of the Study.....	5
1.9 Assumptions of the Study	6
1.10 Operational Definition of Terms.....	6
CHAPTER TWO	7
LITERATURE REVIEW	7
2.1 Introduction.....	7
2.2 The Concept of SMEs.....	7
2.3 Definition and Types of SMES in Kenya	7
2.3.1 Saloons.....	8
2.3.2 Small Hardware	10
2.3.3 Boutiques	10
2.3.4 Cosmetics.....	11
2.4 Funding of SMEs	12
2.4.1 Funding Requirements	12
2.4.2 Models of Funding SMEs from other Countries.....	12

2.5 Characteristics of SMEs as Determinants of Credit Facilities.....	13
2.5.1 Firm Size and Access to Credit.....	16
2.5.2 Age of the Firm and Access to Credit.....	17
2.5.3 Ownership Type and Access to Credit.....	17
2.5.4 Industry sector and Access to Credit	17
2.5.5 Location and Access to Credit	18
2.6 Awareness MFIS Credit Requirements	20
2.7 Credit Policies.....	22
2.7.1 Collateral and Financial Information	24
2.7.2 Asset Tangibility and Asset Base	25
2.8 Micro Finance Institutions	26
2.9 Micro Finance Institutions in Kenya.....	26
2.10 Theoretical Links between Microfinance and SME Development.....	27
2.11 Empirical Studies	29
2.11.1 Empirical Studies on Credit Accessibility	29
2.11.2 Empirical Literature on SMEs in Africa	32
2.12 The gap.....	35
2.13 Conceptual Framework.....	36
CHAPTER THREE	38
RESEARCH METHODOLOGY	38
3.1 Research Design.....	38
3.2 Study Population.....	38
3.3 Sampling Procedures and Sample Size.....	38
3.4 Data Collection Instruments and Procedure	39
3.5 Reliability and Validity.....	40
3.6 Data Analysis and Presentation	40
CHAPTER FOUR.....	41
DATA ANALYSIS AND DISCUSSION.....	41
4.1 Introduction.....	41
4.2 Description of the Research Sample	41
4.2.1 Type of Sampled Business Operated	41
4.2.2 Distribution of the respondents by Gender	42
4.2.3 Age of Business	42

4.3 Effect of SMEs Characteristics on Credit Accessibility Offered by MFIs	43
4.3.1 Age of the Firm	43
4.3.2 Size of the Firm and Access to Credit	44
4.3.3 Ownership of the Firm and Access to Credit.....	46
4.3.4 Industry Sector of the Firm and Access to Credit.....	47
4.3.5 Location of the Firm and Access to Credit	49
4.4.1 Financial Statements and Access to Credit.....	50
4.4.2. Credit Scoring and Access to Credit.....	52
4.5 Effect of Credit Policies on Access to Credit	53
4.5.1. Past Credit Lending History and Access to Credit	53
4.5.2 Cost of Lending and Access to Credit	55
4.5.3 Lack of Training and Access to Credit	56
4.5.4 Collateral and Access to Credit.....	57
4.6 Accessibility to Credit from MFIs by SMEs	58
4.7 Hypothesis Testing.....	60
4.7.1 Correlation Analysis	60
4.7.2 Regression Analysis.....	63
CHAPTER FIVE:	66
SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS	66
5.1 Introduction.....	66
5.2 Summary of Findings.....	66
5.3 Conclusion	67
5.4 Recommendations.....	68
5.5 Suggestion for Further Research.....	68
REFERENCES.....	69
APPENDIX I: QUESTIONNAIRE	82
APPENDIX II: LETTER OF AUTHORITY TO COLLECT DATA	88
APPENDIX III:	89
SUMMARY OF SMES IN NAKURU MUNICIPALITY AS AT JANUARY 2013	89

LIST OF TABLES

Table 4.2.1. Type of business operated.....	41
Table 4.3.1 Effect of Age of the Firm on Access to Credit	43
Table 4.3.2 Effect of Size of the firm on Access to Credit.....	45
Table 4.3.3 Effect of Ownership of the Firm on Access to Credit	46
Table 4.3.4 Effect of Industry sector of the Firm on Access to Credit	48
Table 4.3.5 Effect of Location of the Firm on Access to Credit.....	49
Table 4.4.1. Effect of Financial Statements on Access to Credit	51
Table 4.4.2 Effect of Credit Scoring on Access to Credit	52
Table 4.5.2 Effect of Cost of Lending on Access to Credit.....	55
Table 4.5.3 Effect of Lack of Training on Access to Credit.....	56
Table 4.5.4 Effect of Collateral on Access to Credit	57
Table 4.6.1 Access of Credit by SMEs	59
Table 4.7.1 Correlation Analysis Results	61
Table 4.7.2 Regression Analysis Results	64
Table 4.7.3 Regression Analysis Results	65
Table 4.7.4 Model Summary	65

LIST OF FIGURES

Figure 2.11.1: Financial Access: Developed Vs. Developing Countries	34
Figure 2.13.1: Relationship between Factors Affecting Credit Accessibility by SMEs	37
Figure 4.2.2. Distribution of the respondents by Gender	42
Figure 4.3.1; Overall Age of Firm Index	44
Figure 4.3.2 Overall Size of the Firm Index	46
Figure 4.3.3 Overall Ownership of Firm Index	47
Figure 4.3.4 Overall Industry Sector of Firm Index	49
Figure 4.3.5 Overall Location of Firm Index	50
Figure 4.4.1 Overall Financial Statement Index	52
Figure 4.4.2. Overall Credit Scoring Index	53
Figure 4.5.1 Overall Past Lending History Index	54
Figure 4.5.2 Overall Cost of Lending Index	56
Figure 4.5.3 Overall Lack of Training Index	57
Figure 4.5.4 Overall Collateral Index	58
Figure 4.6.1 Overall Access to Credit Index	59

LIST OF ABBREVIATIONS AND ACRONYMS

ASBBS: American Society of Business and Behavioral Sciences

CBS-GoK: Central Bureau of Statistics Government of Kenya

FDA: Food and Drug Administration

GoK: Government of Kenya

MFI: Microfinance Institutions

MLE: Maximum Likelihood Estimation

OLS: Ordinary Least Squares

PCSFs: Perceived Critical Success/Failure Factors

SME: Small and Medium Enterprise

VAT: Value Added Tax

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Microfinance is not a new concept. It dates back in the 19th century when money lenders were informally performing the role of now formal financial institutions. The informal financial institutions constitute; village banks, cooperative credit unions, state owned banks, and social venture capital funds to help the poor. These institutions are those that provide savings and credit services for small and medium size enterprises. They mobilise rural savings and have simple and straight forward procedures that originates from local cultures and are easily understood by the population (Germidis et al., 1991). These funds are to finance the informal sector SMEs in developing countries and it known that these SMEs are more likely to fail (Maloney, 2003).

The creation of SMEs generates employment but these enterprises are short lived and consequently are bound to die after a short while causing those who gained job positions to lose them and even go poorer than how they were. It is not until recent that microfinance had gained recognition thanks to the noble prize winner Yunus Muhammad of the Grameen Bank. It should be noted that microfinance is not a panacea but it is a main tool that foster development in developing countries. It is known worldwide that the poor cannot borrow from the banks. Banks do not lend to them because they do not have what is required to be granted a loan or to be provided with the bank services. The lack of financial power is a contributing factor to most of the societal problems. These problems emanate from poverty and it is known that with poverty one is bound to suffer so many consequences ranging from lack of good health care system, education, nutrition, Microfinance has proved this bank concept to be wrong. They target the poor who are considered risky but the repayment rate turns to be positive as compared with the regular commercial banks (Zeller and Sharma, 1998). Researchers have viewed microfinance in different dimensions. Microfinance gives people new opportunities by helping them to get and secure finances so as to equalise the chances and make them responsible for their own future. It broadens the horizons and thus plays both economic and social roles by improving the living conditions of the people (Microfinance Radio Netherlands, 2010).

According to Ledger wood (2002) the term microfinance refers to the provision of financial services to low income client including self employed. Integrated Microfinance Bank (IMFB 2007) was of the opinion that microfinance is the supply of loans, savings and other basic financial services to the poor. Everyone needs a diverse range of financial instruments to run their business, build asset, stabilize consumption and shield the SMEselves against risks. Financial services needed by the poor include working capital loans, consumer credit, savings pension insurance and money transfer services. Olaitan (2001) opined that microfinance is the entire flexible structures and processes by which financial services are delivered to micro entrepreneurs as well as the poor and low income population on a sustainable basis. It recognized poor and micro entrepreneur who are excluded or denied accesses to financial services on account of their inability to provide tangible assets as collateral for credits facilities.

Microfinance can be seen as a supply of loans, savings and other financial services to the poor. It is the practice of delivering those services in a sustainable manner so that poor households will have access to financial services so that they can build sustainable micro enterprise. While microenterprise is a business that is independently owned and operated by its owners and does not meet certain standards of size which in most cases operated as informal business. According to Johnson and Rogaly, (1999) very small deposits and loans are referred together as microfinance. Also Rutherford (2000) stated that access to microfinance is very important because it enables the poor to create, own and accumulate asset and smooth consumption. Microfinance involves the provision of credit, savings, repositories, and financial services to low income earners or poor households to create or expand their economy and to improve their standard of living, (Olaitan 2001).The similarity among all the definitions above is that microfinance is about the provision of financial services to the poor, low-income earners and people operating small business in order for them to improve their standard of living.

Financial access can help firms start up and expand their businesses through *inter alia* development of new products and production processes, and investment in human capital. A variety of financial services (credit, savings, insurance, and payment facilities) are crucial for growth in the SME life cycle; however, the focus of this report is on expanding access to finance. Firms often depend on informal sources of funding in the very early stages of their

development. External sources, however, become more important as firms start expanding, and their availability can determine decisively the growth trajectory of SMEs (Klapper, 2006). Internal financing sources typically include an entrepreneur's own savings, retained earnings, or funding through the sale of assets. The external sources of finance can be informal (family and friends or supplier finance) and formal (debt or equity). SMEs are widely defined in terms of their characteristics, which include the size of capital investment, the number of employees, the turnover, the management style, the location, and the market share. Country context plays a major role in determining the nature of these characteristics, especially, the size of investment in capital accumulation and the number of employees. For developing countries, small-scale enterprises would generally mean enterprises with less than 50 workers and medium size enterprises would usually mean those that have 50-99 workers.

In more developed economies, the dynamic arguments for the existence of SMEs have been stressed in terms of their being more innovative and constituting a seedbed for the development of new firms. In Kenya, SMEs are increasingly taking the role of the primary vehicles for the creation of employment and income generation through self-employment, and therefore, have been tools for poverty alleviation. SMEs also provide the economy with a continuous supply of ideas, skills and innovation necessary to promote competition and the efficient allocation of scarce resources.

While the income accruing to the entrepreneurs and the expansion of their businesses is affected, a similar effect is exerted on the economy as a whole. The growth and development of the country is slowed. Research by Ariyo (2000), argued that enterprise, especially the small and medium scale enterprises significantly contributes to the growth of an economy. In fact, there are evidence of countries that has achieved economic transformation through the encouragement and promotion of entrepreneurship activities; among such is China. According to Bharti and Shylendra (2011) access to capital is critical in the promotion of entrepreneurship development particularly microenterprises. Similarly, Simtowe and Phiri (2007) and Muktar (2009) stated credit as a precondition to the growth of enterprises (entrepreneurship).

1.2 Statement of the Problem

The development and sustainability of the SMEs in the Kenyan economy is of paramount importance if the dream of wealth creation is to be realized at all. The main sources of credit to SMEs are relatives and friends, formal banks, MFIs and personal savings. There has been a lot of emphasis on provision of financial services to SMEs in form of credit Joshi, (2005). Despite that MFIs are supposed to play a catalytic role in facilitating economic growth through SMEs, the SMEs have continually faced persistent barriers in accessing funds for investments Obwori. E *et al*, (2012). This study therefore sought to evaluate the factors affecting SME's in accessing credit from micro finance institutions in Nakuru, Kenya.

1.3 Purpose of the Study

The purpose of this study was to evaluate factors affecting access of credit by SMEs from MFIs within the Nakuru Municipality, Kenya

1.4 Research Objectives

The specific objectives included:

- i. To determine the extent to which SMEs characteristics affect accessibility to credit offered by MFIs
- ii. To determine the extent to which awareness of MFIs requirements affects accessibility to credit by SMEs
- iii. To evaluate whether credit policies of MFIs affect accessibility to credit by SMEs

1.5 Research Hypotheses

The study tested the following null hypotheses:

H₀₁: The SMEs characteristics did not significantly affect accessibility to credit offered by MFIS

H₀₂: Awareness of MFIs requirements did not significantly affect accessibility to credit by SMEs

H₀₃: The credit policies of MFIs did not significantly affect accessibility to credit by SMEs.

1.6 Significance of the Study

This study serves as a revelation for all MFIs in designing and implementing effective loans schemes directed to SMEs so that the impact of these loans can be realized. This study will

help policy makers and financial institutions in the formulation of appropriate policies that will help overcome barriers faced by SMEs in accessing credit from MFIs. Policy interventions and strategies that are viable will be developed to enhance access of credit by SMEs and empower them. The research results can be used to encourage the governments and development organizations to focus on the promotion of SMEs through access to credit as a way of encouraging broader participation in the private sector. The promotion of SMEs and, especially, of those in the informal sector is viewed as a viable approach to sustainable development because it suits the resources in Kenya. SMEs are the main source of employment in developed and developing countries alike, comprising over 90% of African business operations and contributing to over 50% of African employment and GDP (Okafor, 2006), hence access to credit will increase these employment levels. This will in then lead to increased participation of indigenous people in the economy, use mainly local resources, promote the creation and use of local technologies, and provide skills training at a low cost to society. The study will also serves as reference point for researchers interested in micro finance and related issues.

1.7 Scope of the Study

To cover all the regions in the entire Nakuru County was impossible because of the limited timeframe. The study covered SMEs like boutiques, saloons, cosmetic shops and small hardware's within Nakuru Municipality. Factors affecting access of credit by SMEs in MFIs this area were analyzed, looking at their effects in accessing credit facility by SMEs.

1.8 Limitations of the Study

The study was limited to SMEs and the following credit accessibility factors; characteristics of the firm, awareness of MFIs Requirements and credit policy. Other enterprises were not included in the study. It sought to evaluate the factors affecting credit accessibility of SMEs from MFIs. There may be other factors that affect credit accessibility that were not included. This implies that the result of this study can only be generalized with caution to the rest enterprises that were included in this research.

1.9 Assumptions of the Study

It was assumed that the respondents would give their frank feelings to the questions posed to them. The researcher assumed that environmental factors such as locality of the SMEs, category and size of the SMEs had no significant influence on the credit accessibility

1.10 Operational Definition of Terms

Micro-financing

Micro-financing is the provision of financial services to low income clients who include customers and self employed individuals that traditionally lack access to banking and related services.

Microfinance institutions (MFIs):

These are financial institutions that offer credit facilities to individuals and businesses for an agreed period of time.

SME:

The research considered a small enterprise to be that consisting of 10-99 employees, a turnover of less than Kshs 0.5 million annually and an asset base of Kshs 100,000 or less.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter describes the SME life cycle and financing needs, and reviews information about the SME financing gap based on the available data from the enterprise and financial institution sides. The chapter also discusses the reasons why SME finance access remains a challenge, stressing the lingering deficiencies in the legal/regulatory frameworks and in financial infrastructures of many emerging countries.

2.2 The Concept of SMEs

There is no single criterion for classifying business enterprises as small or medium scale globally. In a study carried out by International Labour Organization (2005), over 50 definitions were identified in 75 different countries. However, evidence from literature shows that in defining small-scale business, reference is usually made to some quantifiable measures such as: number of people employed by the enterprises, investment outlay, the annual turnover (sales) and the asset value of the enterprise or a combination of these measures Atieno, (2001). The United Nations Economic Commission for Asia and the Far East defined a Small Scale Industry as one operated mainly with hard labour usually not exceeding 50 workers, if no motive power is used or 20 workers if motive power is used. In Indonesia, an industry is considered small if it employed less than 10 full time workers and does not use motive power. The Indonesian definition does not exclude household and cottage industries. The Centre of Management Sciences in Delft University, the Netherlands, for instance, classifies handicrafts and cottage industries as establishments employing less than 10 persons. To them small scale industries are firms employing 10-99 persons in which the manager personally performs all the management functions without taking part in actual production Coleman, (1999).

2.3 Definition and Types of SMES in Kenya

The term SME covers a wide range of definitions and measures, varying from country to country and between the sources reporting SME statistics. Although there is no universally agreed definition of SME some of the commonly used criteria are the number of employees, value of assets, value of sales and size of capital as well as turn-over. Among them the most common definitional basis used is employees because of the comparatively ease of collecting

information and here again there is variation in defining the upper and lower size limit of an SME. In developing countries the number of employees and size of assets or turnover for SME tend to be much smaller compared to their counterparts in developed countries due to their relative size of business entities and economies.

Micro-enterprises are very small businesses, often involving only the owner, some family member(s) and at the most one or two paid employees. They usually lack 'formality' in terms of business licenses, value-added tax (VAT) registration, formal business premises, operating permits and accounting procedures. Most of them have a limited capital base and only rudimentary technical or business skills among their operators. However, many microenterprises advance into viable small businesses. Earning levels of microenterprises differ widely, depending on the particular sector, the growth phase of the business and access to relevant support. Small enterprises constitute the bulk of the established businesses, with employment ranging between ten and about 99. The enterprises will usually be owner-managed or directly controlled by the owner-community and are mostly family owned. They are likely to operate from business or industrial premises, be tax-registered and meet other formal registration requirements. Classification in terms of assets and turnover is difficult, given the wide differences in various business sectors like retailing, manufacturing, professional services and construction – Lack formalities Coleman, (1999).

2.3.1 Salons

Hair dressing salons are beauty outfits. Their services mostly apply to women although in some very limited cases, they attend to men. They render such services as hair washing, perming“, fixing of weave-on, braiding, weaving, plaiting and hair dyeing, manicure, pedicure and hair-cut. Salons fall under SMEs category of business. The benefits of SMEs to any economy are easily noticeable (Olokoyo, 1999).That is why they are believed to be the engine room for the development of any economy, because they form the bulk of business activities in a growing economy like that of Kenya. Salon services come in different forms and styles. The resources at the disposal of a typical hair dressing salon can be broadly categorized into two (2): tools and consumables. The tools are usually in the form of dryers, wash-hand basins, rollers and clips/pins. The consumables exist in the form of creams, relaxers, hair foods, weave-on and the likes. The tools, especially the dryers can be safely classified as assets and last for a while. The consumables are purchased and used up

frequently depending on the rate of customers' turnout (Olaniyan, 2001). The successful operation of a hair dressing salon depends on its location, regularity and constancy of electricity and water supply, the strength of customer relations, the skill of attendants, and the number of service points. On the other hand, the problems of hair dressing salons include job insecurity, severe competition, uncertainty about business future, irregular and erratic power and water supply, high labour turnover, fragile customers' relationships, poor location and the likes. These problems affect the salons in such a way that their operations are less effective and profitable.

The salon has its own routines and invisible tracks along with staff walk in greeting clients, guiding them to treatment rooms, offering refreshments, and finally leading to the point where payment is made. Salons have their own smell which is that of the equipment and chemicals used for treatments, intermingled with the pleasant aromas of perfumed creams and lotions, cups and tea and coffee, and sometimes too the strong smell of nails products. It is in this atmosphere that intimate routines of body maintenance are carried out. The beauty salon is after all a business venture and, while guided by professional ethics, the motivation is profit. The beauty salon industry itself may be understood in relation to consumption practices and processes of exchange. While focusing on the relationships of friendship and intimacy which may form within the salon. It is also important to maintain an awareness of the economic base to the activities being carried out there. Beauty therapists are not part of a high –status occupation and are aware of the negative associations of their work. These negative associations arise for several reasons. Beauty therapists are employed in a feminized industry with an overwhelmingly female clientele. Their work is closely associated with the body in a way which is open to misinterpretation (Callaghan 1994).

An observation of the hair-dressing salons in shows that most of them have such problems as lack of structure; non-availability of initial capital; scarcity of high caliber employees; paucity of quantitative data; limited reserves; competitive weakness; inability to change and adapt rapidly; misconception of government policies; low productivity; loss in realization of the human resource within the enterprises; narrowed service range; over extension of credit; inventory imbalance; excessive overhead and operating costs. Other problems of the hair-dressing salons include: uncoordinated business ideas and plans; non-bankable projects by entrepreneurs; inability to satisfy high credit risk standards, including security/collateral;

inability of banks to provide long-term funds due to mismatch between tenor of bank deposits and loans being sought; fluctuating and prohibitive interest rate regime, and volatile exchange rate regime.

2.3.2 Small Hardware

Construction investment accounts for nearly 52.4% of the Gross Fixed Capital Formation. Investments in construction have a positive domino effect on supplier industries (hardwares), thereby contributing immensely to economic development. Construction materials accounts for approximately 8.6% of India's GDP and accounts for nearly two-third of the total construction costs on an average (Mead & Morrisson, 1996). The share of construction materials in project costs ranges from 40-60%. Construction component comprises nearly 60-80% of project cost of infrastructure projects like roads, housing etc. In projects like power plants, industrial plants, etc. the share, though lower, is critical.

Hardware stores provide consumers with tools and construction materials needed to build, maintain, and improve their homes and properties. Examples of home improvement merchandise are as follows: automotive supplies, building materials, electrical supplies, hand and power tools and accessories, hardware, home decorating products, house wares, lawn and garden items, lumber, paint/paint sundries, plumbing/heating/cooling products, sporting goods and more. The perception that this industry is dominated by big players is just that, a perception. Although retail chains are important in this industry, in no way do they control the total retail distribution channel. They may have the bigger market share but small to mid-size hardware stores do enjoy their own portion of the consumer pie (Mead & Morrisson, 1996). In fact, studies reveal that independent hardware stores can compete successfully with the large chains. In some cases, consumers find them better than corporate chains because of their personalized approach. Small Hardware gets their stock from, full line hardware wholesalers, direct from the manufacturers, and secondary or specialty distributors. The usual avenue chosen by most independent hardware store owners is via wholesalers. When affiliating with wholesalers, you get to receive marketing and advertising support as bonus.

2.3.3 Boutiques

A boutique, or specialty shop, is typically an independently owned store with an emphasis on product uniqueness and exceptional service (Bucklin, 1963). Boutique are retail business that

targets a niche market of women/men retailers typically has a significant discretionary income and often associates a social meaning to the places in which they shop (Kincade and Moye, 2003). Additionally, the specialty shop customer generally desires a more sophisticated store environment than that of the mall or discount store shopper and prefers clothing that is current and fashionable (Kincade and Moye, 2003).

2.3.4 Cosmetics

Cosmetics are substances used to enhance the appearance or odour of the human body. They are generally mixtures of chemical compounds, some being derived from natural sources, many being synthetic. In the U.S., the Food and Drug Administration (FDA) which regulates cosmetics, defines cosmetics as "intended to be applied to the human body for cleansing, beautifying, promoting attractiveness, or altering the appearance without affecting the body's structure or functions." This broad definition includes, as well, any material intended for use as a component of a cosmetic product. The FDA specifically excludes soap from this category. A cosmetic shop is that which deals with the above products. SMEs in cosmetics industries tend to increase over the years as new products enter the market.

The cosmetic industry is one of the fastest growing and essential, but cut-throat industries in the world. Kumar and his colleagues (2006) defined the cosmetic industry as "a very lucrative, innovative, and fast paced industry". Cosmetics have grown rapidly in recent decades in keeping up with dramatic growth and aggressive consumption in Asian, Eastern European, and South American markets (Kumar, 2005). According to a global market research firm Data monitor, world market size of production in 2009 was 223.7billion USD and it was a 3.7 percent increase from the previous record of 215.6 billion in 2008. From a regional prospective, the European market accounts for 42.1% of global cosmetic market share, followed by Asia-Pacific with 27.3% of it. Traditional market leaders such as Europe and North America has been regressing, while Asia, Latin America, Middle East, and Africa markets have been increasing since 2005 (Korea Health Industry Development Institute, 2010).

Beauty has been viewed as an important issue for women. The desire for beauty has been the greatest concern of humanity across ages around the world. Cosmetics are very closely linked to beauty because makeup has been observed as an important method to express a women's

desire for beauty along with clothing and accessories. Cosmetics have been around for thousands of years ago and the use of cosmetics can be traced back to ancient times from the Egyptian, Greek, and Roman eras (Kumar, 2005; Kumar, Massie, & Dumonceaux, 2006). At present, majority of women start their daily routines by wearing cosmetics. Applying cosmetics is a natural behavior for women and has become a major part of modern women's daily life.

2.4 Funding of SMEs

2.4.1 Funding Requirements

In the words of Muktar (2001), SMEs need funds to bring together resources; land, labour and capital equipments, for production to take place. Unfortunately SMEs have been discriminated against by formal financial institutions because of the high risk and small volume of credit required per SME. Access to finance for SMEs has, therefore, been a major issue in literature of economic and industrial development. This is in spite of the potentials of SMEs to contribute to the economic wellbeing of the State. For example, Sule, (1986) opines that, SMEs provide effective means of stimulating indigenous entrepreneurship, enhance greater employment opportunities per unit of capital invested and aid the development of local technology.

2.4.2 Models of Funding SMEs from other Countries

Different countries in the attempt to encourage establishment and sustenance of SMEs have come up with diverse models. The Indian model is to regard SMEs as eggs that hatch big businesses. In that regard, Indian government provides adequate incentives and as well supports SMEs by buying in bulk their products and thereafter retailing them both in the domestic and exports markets. To facilitate their access to bank credits, the government issues SMEs local purchasing orders and banks accept such contract papers as collateral. When small business bid for Government contracts with big ones, big businesses must bid 15% less than small businesses for them to supply government needs. Payments are promptly made to the SMEs and this encourages their growth. In essence there is a given level of encouragement from government to nurture SMEs (Binks, 1996).

In Bangladesh, the Grameen model is adopted, where banks target potential borrowers for its core operations and form them into groups. Then soft loans are made available to these

SMEs, repayable within a specific period before others in that strategic group can benefit from the scheme. With this system there is a subtle pressure from other SMEs that are members of this strategic core on the benefiting group to repay so that others can benefit from the scheme. This has introduced healthy capitalization among SMEs in Bangladesh through factoring the credibility of the borrowers. The Brazilian model has the main thrust of government providing infrastructure in an area to encourage clustering of industries apart from heavy funding and subsidies enjoyed by the SMEs. For example, the SINOS VALLEY shoe cluster industries in Brazil have revolutionized the Brazilian shoe industry, such that not less than 500 SMEs that produce shoes are located in the area. This has made Brazil the third largest shoe exporter “*Annual Report 2002-2003*” -Central Region Grameen Bikash Bank, Nepal.

2.5 Characteristics of SMEs as Determinants of Credit Facilities

All SMEs require financing to grow and the source may be internal or external. The external sources constitute loans, equity infusions, subsidies, or government grants. The internal source is income generated from cash flows that are reinvested Beck, (2005). Many SMEs are self-financing by friends and family members at the beginning stage of development but when it gets to a later stage in development, external financing become necessary. Banks find it hard to grant loans to SMEs until when they find it have a stable growth. More so they need to have a track record of their activities, sufficient collateral or adequate guarantees.

The provision of credit has increasingly been regarded as an important tool for raising the incomes of SMEs and, mainly by mobilizing resources to more productive uses. As development takes place, one question that arises is the extent to which credit can be offered to the SMEs to facilitate their taking advantage of the developing entrepreneurial activities (Hossain, 1988). The generation of self-employment in non-farm activities requires investment in working capital. However, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans, by increasing family income, can help the individuals to accumulate their own capital and invest in employment-generating activities (Hossain, 1988).

Commercial banks and other formal institutions fail to cater for the credit needs of smallholders, however, mainly due to their lending terms and conditions. It is generally the

rules and regulations of the formal financial institutions that have created the myth that the SMEs are not bankable, and since they can't afford the required collateral, they are considered uncreditworthy (Adera, 1995). Hence despite efforts to overcome the widespread lack of financial services, especially among smallholders in developing countries, and the expansion of credit in the rural areas of these countries, the majority still have only limited access to bank services to support their private initiatives (Braverman and Guasch, 1986).

In the recent past, there has been an increased tendency to fund credit programmes in the developing countries aimed at small-scale enterprises. In Kenya, despite emphasis on increasing the availability of credit to small and microenterprises (SMEs), access to credit by such enterprises remains one of the major constraints they face. A 1995 survey of small and microenterprises found that up to 32.7% of the entrepreneurs' surveyed mentioned lack of capital as their principal problem, while only about 10% had ever received credit (Daniels et al., 1995). Although causality cannot be inferred a priori from the relationship between credit and enterprise growth, it is an indicator of the importance of credit in enterprise development. The failure of specialized financial institutions to meet the credit needs of such enterprises has underlined the importance of a needs oriented financial system for rural development. Experience from informal finance shows that the rural poor, especially women, often have greater access to informal credit facilities than to formal sources (Hossain, 1988; Schrieder and Cuevas, 1992; Adams, 1992). The same case has also been reported by surveys of credit markets in Kenya (Daniels et al., 1995).

Access to financial services by smallholders is normally seen as one of the constraints limiting their benefits from credit facilities. However, in most cases the access problem, especially among formal financial institutions, is one created by the institutions mainly through their lending policies. This is displayed in the form of prescribed minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes (Schmidt and Kropp, 1987). For small-scale enterprises, reliable access to short-term and small amounts of credit is more valuable, and emphasizing it may be more appropriate in credit programmes aimed at such enterprises. Schmidt and Kropp (1987) further argue that the type of financial institution and its policy will often determine the access problem. Where credit duration, terms of payment, required security and the provision of supplementary

services do not fit the needs of the target group, potential borrowers will not apply for credit even where it exists and when they do, they will be denied access.

New businesses have problems in getting a favorable position in the market. Their existence is determined by their size and age. If it continues to exist, it means it is capable of maintaining its size or it is expanding. This of course goes with time and when they continue to exist, it means resources are acquired or unlimited (Freeman, 1982). This process of gaining stability and to survive makes the firm to gain legitimacy and thus can be trusted as a successful business since it emits positive signals (Singh, Tucker and House, 1986). Firms with unlimited resources at the infancy stage are easy to go bankrupt and die in this early stage (Aldrich and Auster, 1986; Carroll and Delacroix, 1982; Freeman, Carroll and Hannan, 1983; and Stinchcomb, 1965). Firms that are young and small are incapable of getting the available resources for the proper functioning of its business activities and they are always associated with external organizations in a vertical manner for support (Stinchcomb, 1965). The integration of the young firm with a well established one gains ground for available resources such as funding and legitimacy (Hannan and Freeman, 1984). Businesses employing this approach to gain legitimacy are at risk since they are not independent. The other activities will have an influence in the outcome of the other. Its competitors along with others get to know the inner dependent firm which the competitor will use it as its strength. They get to know the weaknesses of the opposing firm but at the same time they will enjoy the benefit of transaction cost. The reduction of costs is due to the fact that they integrate with others to realize their objectives. This is done by gaining the inside of the quality of work, production and ideas within its top level (Hannan and Freeman, 1984).

External sources of funding have more moral hazard problems and consequently the demand for own or internal finances are of paramount to the firm (Myers, 1984). This moral hazard is explained by the fact that SMEs are very close entities; that is owned and or controlled by one person or few people (Watson and Wilson, 2002). POT emphasises; Ang (1991) on the use of owned capital rather than outside capital by SMEs and also explain why SMEs are denied or has a hindering factor in seeking for external sources of finance. World Bank (2000) reiterates the fact that SMEs are more likely to be denied new loans for their businesses than larger firms when in need. They consider SMEs to lack the skills to manage

risk and the high transaction costs in lending to them compared to the amount that is borrowed (Hallberg, 1994).

2.5.1 Firm Size and Access to Credit

Firm size is one of the most important variables in literature related to access to credit. This was true for both developed as well as developing countries. Numerous studies have discussed that small and medium enterprises are financially more constrained than large firms. For example, Proceedings of ASBBS Volume 18 Number 1 ASBBS Annual Conference: Las Vegas 258 February 2011 Calomiris & Hubbard (1990) noted that when the company is smaller, the restrictions on credit are greater.

Previous studies have mentioned several reasons for small firms to have less access to credit. Firstly, the small firms face with information opacity such as unable to provide financial information (Binks & Ennew 1996). When the firm is small, most of the time it is owned and operated by the entrepreneur himself and there is no such legal requirement to regularly report financial information and many firms do not maintain audited financial accounts.

Smaller firms have fewer assets to offer as collateral. In order to reduce the anticipated risk and moral hazard associated with lending, the banks use collateral as one of the instrument. The collateral is an assurance to the bank in case of default and it also ensures the borrowers commitment to the loan repayments. Berger and Udell (1995) found smaller and younger firms are more likely to face higher cost of financing and they are required to offer collateral.

Smaller the firm, there is high risk involved because small firms have high failure rate compared to large firms. For example, Schiffer and Weder (2001) sampled firms across a number of countries and found that there was a negative relationship between the size of a business and the risk it might pose for a lender. In contrast, Lopez- Gracia and Aybar Arias (2000) came up with a different explanation stating that the smaller firms may themselves limit their financial structure with the aim of avoiding the need to share control of the business with others.

2.5.2 Age of the Firm and Access to Credit

Firms' sources of finance change over time. For instance, a firm may start as a family owned business, by using its internal financing sources such as personal savings and family finance. Subsequently, it will then grow to obtain funds from its suppliers. The studies conducted in the past have found that the financing constraints are particularly severe in start-up enterprises and relatively young firms (three years old or less). For example, Aryeetey et al (1994) conducted a survey of 133 firms, of which 76 had less than 10 workers, in various industries in Ghana in the early 1990s. They found that only 10 percent of startup firms in Ghana could obtain bank loans but medium size enterprises and older firms are provided with credit three times more often than their smaller counterparts. The similar survey was conducted Levy (1993) in Sri Lanka and Tanzania and reported that 80 percent of firms with 16 or more workers and with 6 or more years in operation are able to access bank loans, compared to the success rate of around 55 percent in the case of smaller firms with 6-15 employees of similar age, and less than 10 percent for firms with 5 or fewer workers, regardless of age.

2.5.3 Ownership Type and Access to Credit

Entrepreneurs choose ownership structures in large part to ensure adequate financing and because of the selection effect whereby finance goes to firms with conducive ownership structure. Ownership structures in the firms can influence the ability to have access to finance. For example, previous research has found that listed firms and foreign owned firms face lesser financial constraints (Harrison and McMillan, 2003; Beck et al, 2006). Storey (1994), found that legal status influence the bank lending. He further states that corporate status at start up appears to be associated with a greater likelihood of bank lending.

2.5.4 Industry sector and Access to Credit

Industry sector also can be stated as a factor affecting access to finance. The lending banks may have favouritism towards to industry sectors that are growing. For example, some studies have shown that industries with significant external financing needs, such as textiles, machinery or drug manufacturing, have grown more rapidly in countries with greater financial development (Levine, 2004). The research done by Byiers et al (2010) using data from Mozambican manufacturing firms also found that sector seems important for having credit access. The results of their research indicated that both metal-mechanic and wood-

furniture sectors have significantly lower credit access than the food processing sector. Their interpretation for this was that banks attach a lower risk premium to food processing sector compared to other two sectors.

On the other hand some industries are more likely to depend on external financing than others, depending upon project scale, and cash flows. Firms in certain sectors will require more credit to invest in equipment, machinery, buildings, labour and raw materials than firms in other industry sectors. For instance, the industries with more capital requirements may face proportionately greater constraints (Kumar & Francisco, 2005). Silva and Carreira (2010) argue that, for most services, the main input is human and not physical capital and therefore service sector firms find it hard to use this physical capital as collateral when resorting to external finance. Previous research has also found that the survival rates of small businesses vary between sectors (Gimeno et al ,1997; Storey & Wynarczyk 1996).

2.5.5 Location and Access to Credit

It can be argued that spatial variations exist in both the cost and availability of finance, especially for small firms. There are a variety of factors which may contribute to spatial variations in the availability of bank finance for small firms in rural areas. Firstly, there may be an absence of financial institutions in these rural areas. Sometimes, there may be a single bank branch available to the location, which may enjoy a „monopoly power“ in the area, and small firms may not have much financing alternatives available. Due to this, they may end up paying high interest on bank loans or may have to adhere to restricted covenants such as collateral and other conditions Schiffer, (2001).

Secondly, the bank branch managers assigned in these rural bank branches may have limited delegation of authority. As a result, there may be delays in approving loans requested by rural firms or high amount of loan rejections, as the bank loans are processed and approved by the head office officials who have no personal knowledge of customers or projects based in rural locations. Thirdly, banks may be reluctant to lend to small firms located in rural areas, as the assets offered as collateral by these firms may have less market value, and in case of default, they may find it difficult to realise these assets. However, the previous studies done in this topic have contradictory views: Keeble (1999a) investigated the constraints to growth experienced by urban and rural firms in the UK and suggest that the problems facing firms in urban and rural areas are broadly similar except finance. They reported that only significant

difference is that rural firms feel themselves more constrained in terms of finance compared to the urban firms. O'Farrell (1990) suggests on the basis of research in Nova Scotia, Canada that banks appear to be more reluctant to lend to small firms in rural areas, because if the firm fails, the bank considers that it will be more difficult to sell the assets. Kumar & Francisco (2005), also found that there is a large variation in branch density across different regions in Brazil and argued that well branched regions in Brazil would be expected to ease physical access and also lower information asymmetry problems as a consequence of greater ratios of banks per firm and they argued that the firms located in these regions have ease of access to credit.

However, Perry (1988) found no clear evidence that small firms in a rural region of New Zealand are disadvantaged in the search for debt finance. Tucker and Lean (2001) also examined the relationship between firm location and success in obtaining external finance, by dividing the firms into two groups, the first containing firms located in the north of the England and the second containing firms in the south, found that there was no significant variations exist, although there is some indication that firms in the south of England are more successful in obtaining term loans guaranteed under the Small Business Loan Guarantee Scheme. However, a difference of opinion was found by (Rand, 2007). According to him, probability of accessing credit is higher in rural than in urban areas. He further states that "most of government bank credit is allocated towards rural areas confirming that local governments often are distinctly protective of firms in rural areas, which are more oriented towards serving local markets and therefore tend to escape from some of the credit barriers inherent in larger, possibly more outward oriented markets"(Rand, 2007).

Another contradictory argument of some researchers is that the distance between lenders and borrowers has no influence on financing small businesses is the development of new Proceedings of ASBBS Volume 18 Number 1 ASBBS Annual Conference: Las Vegas 261 February 2011 technologies. These changes in technology have lowered search costs enabling easier access to lenders. However, this argument has not got much relevance with the SMEs located in the developing countries due to limited developments in the information technology and limited usage of such services by the SMEs.

2.6 Awareness MFIS Credit Requirements

Access to financial services by small-scale entrepreneurs is normally seen as one of the constraints limiting their benefits to improve their economic status (CBS/ICEG/K-Rep, 1999). In most cases the access problem especially experienced from formal financial institutions is one created by the credit institutions. Commercial banks and other formal institutions fail to cater for the credit needs of smallholders mainly due to their lending terms and conditions. Generally, it is the rules and regulations of the commercial financial institutions that have created the perception that since the poor cannot afford the required collaterals (land/Buidings title Deeds), they are considered un-credit worthy (Adera 1995). For comparison purpose, financial services in the informal sector are client oriented. Transaction costs are reduced making the services attractive to customers but they have high explicit costs (Atieno 2001). This contrasts with the formal lender practices, which charge relatively low interest rates but often impose procedures on borrowers that substantially increase their transaction costs. Also, there are the government formal financial lending institutions and programmes such as KIE, ICDC (current Centum Investment), K-rep, KWFT, and JLBS which were developed with considerable flexibility to enable low income earners to access credit. Demand for credit from these institutions has not been impressive despite the financial constraints experienced by the SMEs.

The supplementary survey of Kimuyu and Omiti (2000) on institutional impediments to access to credit by micro and small scale enterprises in Kenya, showed that even in some of the relatively large urban centers such as Mwatate in Coast Province of Kenya, entrepreneurs had not heard of some of the more popular microfinance institutions. Using descriptive statistics and simple regressions (logit estimates and OLS analysis), there were observed differences in the amounts borrowed by entrepreneurs in different business activities and in the level of loan applications in relation to gender, location of enterprise and formality status of the enterprises. These factors were reported to be complimented by entrepreneur's age, educational achievements, membership in support groups and enterprise size. However, Mpuga (2004) analyzed demand for credit in rural Uganda and the findings were that rural households are at a disadvantage in terms of demand for credit. Whereas being in the rural area has no significant impact on the probability of applying for credit and the success of the application, loan applications for individuals from the rural areas are about 44% smaller in magnitude than that of those in the urban areas.

Atieno (2001) pointed out that access to credit by borrowers can be explained in terms of credit rationing behaviour of lending institutions. Atieno's study used mainly descriptive statistics to analyze the role of institutional lending policies of formal and informal credit institutions in determining access to and uses of credit facilities by small-scale entrepreneurs in rural Kenya. Reports from a randomly selected sample of 334 respondents indicated that 15% had not applied for credit because they had no need for credit therefore classified as not credit constrained. 36% were credit constrained but had not also applied for credit. From the research findings, the major reasons for not seeking credit were lack of information about credit and lack of required security. Only 49% revealed their demand by applying for credit. Amongst this number there were those whose loan applications were rationed and did not get the total amount they applied for. A comparison of the amount applied for and amount received showed that the amount applied for was significantly higher than the amount received from both formal and informal sources. This suggested credit rationing in the credit market. These findings can be assumed not to interpret lack of credit demand among the large number of respondents who indicated did not seek for credit, since only 15% implied they had no need for credit.

Credit rationing has been found to influence credit demand to small-scale investors. This was reported by Okurut (2004). The research focused on identifying factors that influence credit demand and also those that result in the poor being rationed by lenders in Uganda. Using logit regressions, analysis of credit demand was performed at individual levels with dataset containing social economic characteristics of households. The findings reviewed that it is possible most small-scale entrepreneurs who seek credit would be able to obtain it, but costs and conditions may be prohibitive for the high risk borrowers.

Lenders determine how much credit is allocated based on the probability of default, often resulting in credit rationing. According to Okurut (2004) the probability of default may be influenced by a number of factors such as expected returns of the business, the terms of the loan, market imperfections and borrower characteristics. Information asymmetry in credit markets arises because borrowers have better information about their potential risk of default than lenders. This asymmetry is compounded in informal credit markets by the fact that the credit histories of borrowers are not documented in the informal credit markets. The costs of

acquiring this information are very high both in terms of time and financial resources. The other complication comes from its reliability. If lenders collect such information from the potential borrowers themselves, borrowers are likely to give an exaggerated view of their creditworthiness. This calls for an investigation to validate information from other sources. Okurut (2004) further states that if lenders try to collect such information from other community members, there is a tendency to withhold information if the one soliciting such information is a stranger. To compensate for the high cost of information gathering or reliability, lenders consider it logical to increase interest rates. However, should they do so, this may result in lowering demand for the credit. These findings are consistent with Aleem (1990) and Baydas (1994).

Thus lending places emphasis on evaluating information from the firm's financial statements. The decision to lend and terms of the contract are principally based on the strengths of the firm's balances sheet. Financial statement lending is best suited for relatively transparent firms with certified audited financial statements. Thus, it is likely to be the rule of choice for lending to large firms. But when adapting this rule for small firms, the firms must be ones with long histories, relatively transparent transactions and strong audited financial statements (Berger and Udell, 2001).

2.7 Credit Policies

Shortage of credit has been identified as one of the most serious constraints facing SMEs and hindering their development (Oketch et al., 1995; Tomecko & Dondo, 1992; Kiiru, 1991). The Sessional Paper, concurring with these views, proposed policies to alleviate this problem. The paper noted that banks fail to lend to small enterprises for a number of reasons which include past lending experience with SMEs which generated a mind set in the formal financial sector about the high risk and cost of lending to the sector. Further, there were adverse regulations that restricted the flow of funds to the SMES sector. The Sessional Paper proposed that the flow of funds to the SMES sector could be increased by: Deregulation and liberalization of the financial sector to permit banks to charge competitive interest rates and appropriate fees in order to get a fair return on their lending to SMEs. In addition, the government was to introduce appropriate legislative changes that would allow development finance institutions to accept deposits, Government assisting with the sourcing of foreign loans for SMEs and bearing the associated foreign exchange risks in respect of such loans, Government exploring the possibility of establishing an export guarantee insurance scheme

and SMES export finance scheme to increase SMES exports, Increased training for SMES entrepreneurs facilitated through legislative changes such as the revision of the Industrial Training Act, which would allow banks to undertake training of their SMES clients using the levy, Further, banks would be encouraged to strengthen their business advisory services to accommodate the needs of SMEs, A special training fund contributed to by the government, private sector and donor community would also be set up to help train those operating in the sector, Changing the negative perception about the sector within the banking community by carrying out training workshops for bank officials at all levels, which would increase awareness of the potential of lending to the sector and provide best practice techniques of doing so, Reviewing the restrictive collateral requirements and other regulations and procedures that reduced the flow of funds to the sector in order to make them more flexible to accommodate the needs of SMEs, Further, a study would be commissioned Review of government policies for the promotion of micro and small-scale enterprises in Kenya on setting up a national credit guarantee corporation to alleviate the collateral problem for SMEs, External finance of the budget deficit by the government in order to increase availability of credit to the private sector and hopefully to the SMES sector and Setting up a venture capital fund to provide equity capital for SMEs.

Most SMEs mainly rely on own savings and reinvested profits to finance their business. Comparison of results of the three baseline studies done in Kenya of 1993, 1995 and 1999 show minor improvements in the situation—from 9 percent of SMEs accessing credit in 1993 to 10.8 percent in 1999. Formal credit increased from 4 percent to 5.7 percent, a reflection of a rise in the number of NGOs focusing their support on SMEs. The number of NGOs increased from 46 to 130 between 1995 and 1999 (Oketch, 2000). Many of these NGOs however, have limited financial resources and few have systems and organizational structure to support large SMEs. In 1995, the Kenya Rural Enterprise Programme (K-REP) realized that as an NGO, it lacked capacity to serve as an effective financial intermediary and decided to establish a micro-finance bank in 1999.

Formal financial institutions perceive the high risks and transaction costs an impediment to lending to the SME sector. In addition to the limited capacity of banks to lend to SMEs, there is the difficulty of enforcing contracts due to an inadequate legal framework and inefficient court systems. The banking laws and regulations do not currently differentiate the market

segments served by micro-finance institutions. There is need to review the regulations in order to reflect innovations in financing SMEs. Where formal banks have lent to the SME sector, they have simply acted as a channel for funds externally sourced from donors and guaranteed by the government. The fact that there has been no significant lending from the banks own initiative is an indication of a weakness in policy. The banks' continued lack of interest and the subsequent reluctance of the Central Bank to relax the lending requirements to the SME sector might reflect inadequate consultations between stakeholders.

2.7.1 Collateral and Financial Information

The World Bank survey on n firms' access to finance showed that most banks are reluctant to provide long term credit to SMEs. The Grameen Bank experience shows that most of the conditions imposed by formal credit institutions like collateral requirements should not actually stand in the way of smallholders and the poor in obtaining credit. The poor can use the loans and repay if effective procedures for disbursement, supervision and repayment have been established. On the issue of interest rates, the bank also supports the view that high interest rate credit can help to keep away the influential non-target group from a targeted credit programme (Hossain, 1988). This further demonstrates the need to develop appropriate institutions for the delivery of loans to small-scale borrowers. Notable disadvantages of the formal financial institutions are their restriction of credit to specific activities, making it difficult to compensate for losses through other forms of enterprises, and their use of traditional collateral like land. There is need for a broad concept of rural finance to encompass the financial decisions and options of rural economic units, to consider the kind of financial services needed by households, and which institutions are best suited to provide them.

Credit markets in Africa have mainly been characterized by the inability to satisfy the existing demand for credit in rural areas. However, whereas for the informal sector the main reason for this inability is the small size of the resources it controls, for the formal sector it is not an inadequate lending base that is the reason (Aryeetey, 1996). Rather, the reasons are difficulties in loan administration like screening and monitoring, high transaction costs, and the risk of default. Credit markets are characterized by information asymmetry, agency problems and poor contract enforcement mechanisms (Nissanke and Aryeetey, 1995). They are mainly fragmented because different segments serve clients with distinct characteristics.

Because of this, lending units are unable to meet the needs of borrowers interested in certain types of credit. The result is a credit gap that captures those borrowers who cannot get what they want from the informal market, yet they cannot gain access to the formal sources. Enterprises that want to expand beyond the limits of self-finance but lack access to bank credit demand external finance, which the informal sector is unable to satisfy.

2.7.2 Asset Tangibility and Asset Base

Previous researchers suggest that bank financing will depend upon whether the lending can be secured by collateral (Storey, 1994; Berger and Udell, 1998). Johnsen and McMahon (2005) also stated that other factors held constant, firms with more intangible assets need to borrow less, compared with firms with more tangible assets, because of collateral factor. In the previous research, collateral has been proxied by land, machinery or personal assets (Kumar and Francisco, 2005). Bennett and Donnelly (1993), used plant and machinery divided by total assets as a proxy for the securability of assets. Bhaduri (2002), used three proxies for the collateral asset attribute, namely, the ratio of land and buildings to total assets, the ratio of plant and equipment to total assets and the ratio of inventories to total assets.

SMEs have fewer collateralisable assets than large firms. This may partly relate to the stage of growth the firm belongs to. In the earlier stages of the firm, it may have lower retained profits which may hinder them to purchase fixed assets compared to the larger firms which has a longer history. Another reason for small firms to have a smaller proportion of fixed assets is the capital Proceedings of ASBBS Volume 18 Number 1 ASBBS Annual Conference: Las Vegas 262 February 2011 constraints faced by them. Because of the need to raise large amounts of capital, it finds difficult for them to acquire a large number of fixed assets.

The most apparently guaranteed form of lending to SMEs is asset-based lending. This lending technology bases its decision to lend on the quality of the available collateral. This type of lending requires constant monitoring of the business and this can prove to be expensive. The collateral in this case may be accounts receivable and inventory; this is why the bank has to intensively monitor the turnover of these assets. This is the most common lending rule for SMEs Coleman, (2000).

2.8 Micro Finance Institutions

Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses. It is mostly used in developing economies where SMEs do not have access to other sources of financial assistance (Robinson, 1998). In addition to financial intermediation, some MFIs provide social intermediation services such as the formation of groups, development of self confidence and the training of members in that group on financial literacy and management (Ledger wood, 2002). There are different providers of microfinance services and some of them are; nongovernmental organisations (NGOs), savings and loans cooperatives, credit unions, government banks, commercial banks or non bank financial institutions. The target group of MFIs are self employed low income entrepreneurs who are; traders, seamstresses, street vendors, small farmers, hairdressers, rickshaw drivers, artisans blacksmith etc (Ledger wood, 2002).

2.9 Micro Finance Institutions in Kenya

In Kenya, the significance of the SMEs sector can be seen in terms of its contribution to economic development. The CBS/ICEG/K-Rep (1999), revealed the existence of some 1.3 million small enterprises employing as many as 2.4 million Kenyans. CBS-GoK (2007) reported that total employments in Kenya including small-scale activities, stood at 8.7 million persons in 2006, up from 8.3 million recorded in 2005. From the 469 new jobs generated within that period, 89% were in the informal sector. Other studies have shown that the sector is dynamic (Ministry of Labour and Human Resource Development, 2004) and has the potential of generating wide spread economic benefits which in turn lead to reduction of poverty among low income earners.

Kenyan small-scale enterprises are a mixture of self-employment outlets involving a dynamic array of activities mainly concentrated in urban cities/towns and trading centers in the rural areas. These small enterprises cut across all sectors of the Kenyan economy and provide one of the most prolific sources of employment, income generation and poverty reduction (Ministry of Labour and Human Resource Development -GoK, 2004). The sector plays an important role in industrialization, promotion of rural urban balance and indigenous people's participation in the economic development. However, despite the critical role played by the

sector, it is faced with many challenges and constraints that inhibit the realization of its full potential. Lack of power to generate sustainable income from business operations coupled with limited access to financial services are key factors that make the sector players confine themselves to narrow markets where intense competition drive prices down resulting in low profit margins. This has lead to either early deaths of their businesses (closure) or retardation of the enterprises. On the one hand, very few manage to graduate to medium and large-scale enterprises (Ministry of Labour and Human Resource Development - GoK, 2004). On the other hand, credit supply appears to be very high. This is demonstrated by the level of competition among credit lending institutions. Each institution is hawking their own tailor-made credit products that are targeting different needs of low income earners. From this observation, there seems to be an imbalance between utilization of circulating credits and SMEs' growth and expansion.

2.10 Theoretical Links between Microfinance and SME Development

Accessing credit is considered to be an important factor in increasing the development of SMEs. It is thought that credit augment income levels, increases employment and thereby alleviate poverty. It is believed that access to credit enables poor people to overcome their liquidity constraints and undertake some investments such as the improvement of farm technology inputs thereby leading to an increase in agricultural production (Hiedhues, 1995). The main objective of microcredit according to Navajas et al, (2003) is to improve the welfare of the poor as a result of better access to small loans that are not offered by the formal financial institutions.

Diagne and Zeller, (2001) argue that insufficient access to credit by the poor just below or just above the poverty line may have negative consequences for SMEs and overall welfare. Access to credit further increases SME's risk-bearing abilities; improve risk-copying strategies and enables consumption smoothing overtime. With these arguments, microfinance is assumed to improve the welfare of the poor.

It is argued that MFIs that are financially sustainable with high outreach have a greater livelihood and also have a positive impact on SME development because they guarantee sustainable access to credit by the poor. Buckley (1997) argue that, the indicators of success of microcredit programs namely high repayment rate, outreach and financial sustainability

does not take into consideration what impact it has on micro enterprise operations and only focusing on “microfinance evangelism”. Carrying out research in three countries; Kenya, Malawi and Ghana, Buckle (1997) came to the conclusion that there was little evidence to suggest that any significant and sustained impact of microfinance services on clients in terms of SME development, increased income flows or level of employment. The focus in this argument is that improvement to access to microfinance and market for the poor people was not sufficient unless the change or improvement is accompanied by changes in technology and or technique.

Zeller and Sharma (1998) argue that microfinance can aid in the improvement or establishment of family enterprise, potentially making the difference between alleviating poverty and economically secure life. On the other hand, Burger (1989) indicates that microfinance tends to stabilize rather than increase income and tends to preserve rather than to create jobs.

Facts by Coleman (1999) suggest that the village bank credit did not have any significant and physical asset accumulation. The women ended up in a vicious cycle of debt as they use the money from the village banks for consumption purposes and were forced to borrow from money lenders at high interest rate to repay the village bank loans so as to qualify for more loans. The main observation from this study was that credit was not an effective tool to help the poor out of poverty or enhance their economic condition. It also concluded that the poor are too poor because of some other hindering factors such as lack of access to markets, price stocks, unequal land distribution but not lack of access to credit. This view was also shared by Adams and Von Pischke (1992).

A study of thirteen MFIs in seven countries carried out by (Mosley and Hulme (1998) concludes that household income tends to increase at a decreasing rate as the income and asset position of the debtors is improve. Diagne and Zeller (2001) in their study in Malawi suggest that microfinance do not have any significant effect in household income meaning no effect on SME development. Investing in SME activities will have no effect in raising household income because the infrastructure and market is not developed.

Some studies have also argued that using gender empowerment as an impact indicator; microcredit has a negative impact (Goetz and Gupta, 1994; Ackerly, 1995; Montgomery et al, 1996). Using a “managerial control” index as an indicator of women empowerment, it came to conclusion that the majority of women did not have control over loans taken by them when married. Meanwhile, it was the women who were the main target of the credit program. The management of the loans were made by the men hence not making the development objective of lending to the women to be met (Goetz and Gupta, 1994). Evidence from an accounting knowledge as an indicator of women empowerment concluded that women are marginalized when it comes to access to credit (Ackerly, 1995).

2.11 Empirical Studies

2.11.1 Empirical Studies on Credit Accessibility

In the empirical literature, probability models and Ordinary Least Squares [OLS] or Maximum Likelihood Estimation [MLE] models have been applied in the investigation of the banks’ credit rationing behaviour. For the Probit/Logit models, the dependent variable was the probability of being credit rationed [$=1$ if credit rationed, otherwise zero], with explanatory variables being household socio-economic characteristics; enterprise characteristics and loan characteristics depending on the specification of each model. For the (OLS) models, the loan amount supplied by the bank is the dependent variable.

Lapar and Graham (1988) using secondary data for a sample of 344 bank clients and survey data of 65 bank respondents in the Philippines, estimated separated models of the intensity of bank credit rationing and the probability of credit rationing. For rural banks the intensity of credit rationing was significantly reduced by land area and family size, but significantly increased by loan maturity period. The intuition of results is that borrowers with large land holdings were deemed to have a higher capacity to produce which reduces the risk on the loan. The large family size increases the production potential of the borrower and reduces costs/ risks because the household does not hire outside labour. The long loan maturity period was closely associated with greater risk of the loan due to the riskier nature of long term investments. For the private development banks, the intensity of credit rationing was significantly reduced by the value of the collateral offered for the loan, and significantly increased by the loan maturity period. In terms of the logit model results, the probability of being credit rationed by rural banks was positively and significantly influenced by loan

maturity period, but negatively and significantly influenced by interest rate, land area and size of family. The effect of collateral value in reducing intensity of credit rationing by private development banks may be explained by (Goetz and Gupta, 1994) argument that a bigger collateral increases the incentive for the borrower to put in more effort. This is because the opportunity cost of failure will be too high for the borrower in terms of collateral seized by the bank in case of default. Bebczuk (2004) investigated the determinants of access to bank credit by SMEs in Argentina. The study made use of data from a sample of 140 Argentine firms. The main findings were that the size of the firm did not have any significant influence on the firm's probability of getting a loan; however, there was a positive relationship between the firm's profitability and its probability of obtaining a loan; a higher level of liquidity lowered the probability of obtaining a loan, the study attributed this finding to the fact that there is a likelihood for firm owners to misuse funds when faced with a financial distress. The study also found that a higher debt ratio increased the probability of getting a loan; the reason being that prior access to loans gives potential lenders a positive impression of the borrower. However, this may be negated by high levels of debt. Bebczuk (2004) also found that the use of overdraft credit increased the probability of obtaining credit and finally expectations of higher investment or exports appeared not to influence the probability of firms getting a loan.

Hiedhues, (1995) in his study of borrowing by households in Indonesia, observed that human capital (education level and age of household head) and wealth reduces the probability of households being credit rationed by banks. Mosley and Hulme (1998) in their study of borrowing by businesses in Belgium observed that the amount of bank debt supplied to SMEs is positively and significantly influenced by the age of the firm, assets and the cash flow. By implication, credit rationed SMEs are characterized as young, small SMEs with little internal financial resources and a lack of assets to guarantee the repayment of bank loans. Sacerdoti (2005) examined issues of access to bank credit by the private sector in Sub Saharan African countries. This study focused mainly on reviewing the challenges faced by SMEs and the agricultural sector in obtaining bank credit, as well as to identify the ways in which these challenges can be addressed. This paper also sought to examine the potential contribution of the growth of Micro Finance Institutions (MFIs), as well as the improvement of links between these institutions and the traditional banking system to meeting the credit need of SMEs and the agricultural sector. Lastly, the study reviewed the bank interest rate spreads

and profit margins, and then drew comparisons with spreads prevailing in other parts of the world. The study found that modest credit growth was mainly as a result of inadequate information on borrowers; the existence of weak accounting and auditing standards; limitations in credit information sharing as well as in the registration of collateral and real estate and finally a weak regulatory framework governing the enforceability of claims and property rights (Sacerdoti, 2005). The study highlights that these challenges could be addressed through the establishment of credit bureaus; the reinforcement of accounting standards; the updating and strengthening of company registries and the improvement of regulatory frameworks. Freel (2007) investigated the relationship between innovativeness and loan application success. This study used data for a sample of 256 small firms which was part of a wider survey carried out in Britain on firms which had been identified as having applied for bank credit in the period 1998 to 2001. The main findings were that small innovative firms appeared to have a lower loan application success than their less and non-innovative counterparts. This is because of the greater risk of loan default associated with these small innovators. Therefore, due to the presence of information asymmetries and limited security in the market, it is only rational that banks will engage in adverse selection in order to minimize the risks (Freel, 2007).

Beck *et al* (2008) used data from a survey of 91 banks in 45 countries to investigate the bank financing situation to SMEs from the supply side. In particular, the paper aimed to determine the perceptions of banks towards the SME sector; to analyze the role of government programs and other regulations in promoting or deterring SME financing and finally to identify the factors which influenced SME financing, and here the study considered both the challenges and opportunities. Beck *et al* (2008) also sought to determine the business models adopted by banks to serve SMEs, for instance whether the banks had departments specifically for serving SMEs. The study also investigated the criteria used by banks in evaluating loans to SMEs. According to Beck *et al* (2008) banks considered the SME sector to be very profitable, and their perceptions of government programs supporting SMEs were positive. This study also found that the main obstacles to SME financing were macroeconomic instability in developing countries whilst in developed countries it was competition. In addition to this, in order to better serve SMEs, banks had decentralized departments that assist SMEs; however some functions such as loan approval, risk management and loan recovery remained centralized. From the empirical literature, it can be concluded that the key variables that

influence the banks' credit rationing behaviour include the socio-economic characteristics of the borrower (age, wealth, income, asset values), enterprise characteristics (age, internal financial resources), and loan characteristics (loan maturity period, value of collateral).

2.11.2 Empirical Literature on SMEs in Africa

Mukras, (2003) discussed the prospect of strengthening SMEs as a poverty reduction measure in Botswana. This paper drew from the experience of Kenya and provided some policy recommendations based on the constraints faced by SMEs in Botswana. Mukras, (2003) recommended that in order to strengthen SMEs as a poverty reduction measure, SMEs should be provided with capital at a low and affordable rate of interest and appropriate technology should be applied by SMEs in order to assist in achieving their desired objectives. In addition entrepreneurs and the work force should be given the right type of training and deliberate effort should be made in encouraging the advancement of women in SMEs so as to correct the imbalance in the opportunities awarded as well as to facilitate greater involvement of women in SMEs. Temtime and Pansiri (2004) investigated the factors which contribute to the perceived success or failure of SMEs in Botswana. They surveyed 203 SMEs in three cities in Botswana. Their findings were that Perceived Critical Success/Failure Factors (PCSFs) such as human resource developments, managerial background and organizational development had an influence on the performance of SMEs. The study also found relationships between the PCSFs and some firm specific demographic variables such as ownership status, experience and operating period (Temtime and Pansiri, 2004).

Hinton *et al* (2006) sought to describe and estimate the potential market for SMEs and under-banked SME employees in Botswana. In addition to this, they sought to determine the exact nature of the banking needs of these businesses as well as those of their employees, and in particular whether their banking needs was adequately met by the banking sector. This study interviewed 180 SMEs in Gaborone, Francis municipality, Molepolole, Maun and Selibe Phikwe. Their findings were that 15% of the SMEs in Botswana were unbanked with the highest proportion being very small enterprises. In addition to this, a vast majority of employees of very small and small enterprises were found to be unbanked whilst all the employees of medium enterprises were banked. This study concluded that increasing SMEs' access to finance could improve the growth of SMEs in Botswana. Furthermore, involving small business in the formal banking system by providing appropriate products and services

could significantly contribute to the number of people with bank accounts in the economy. Jorosi (2006) carried out an investigation of the information needs and information seeking behaviours of SME managers in the manufacturing sector in Botswana. This study made use of a self-administered questionnaire. The findings were that, SME managers valued customer and competition information; managers devoted a significant amount of time to actively seek information on customers and competition; their information sources are largely determined by availability and ease of use, and the managers used both personal and impersonal sources of information. Kapunda *et al* (2007) examined the relationship between SME financing, development and trade with special gender considerations in Botswana. In particular, this study aimed at identifying the problems faced by female owned/ managed enterprises; how these problems affect the employment, profitability and participation in trade by SMEs and finally how these challenges can be addressed. The study used data based on two own surveys of 100 SMEs in Gaborone and surrounding areas. The main findings were that generally women had difficulties in raising the necessary finance, as well as in competing and accessing markets when compared with their male counterparts. Kapunda *et al* (2007) also found that due to government instituted mechanisms such as CEDA, relatively larger SMEs did not consider limited access to finance as a major problem, this however was not the case for smaller SMEs. The main challenges to SMEs identified by the study were non-payment of outstanding accounts by clients; stiff competition and a lack of market for their goods or services.

An observation of the hair-dressing salons studied shows that most of them have such problems as lack of structure; non-availability of initial capital; scarcity of high caliber employees; paucity of quantitative data; limited reserves; competitive weakness; inability to change and adapt rapidly; misconception of government policies; low productivity; loss in realization of the human resource within the enterprises; narrowed service range; over extension of credit; inventory imbalance; excessive overhead and operating costs. Other problems of the hair-dressing salons include: uncoordinated business ideas and plans; non-bankable projects by entrepreneurs; inability to satisfy high credit risk standards, including security/collateral; inability of banks to provide long-term funds due to mismatch between tenor of bank deposits and loans being sought; fluctuating and prohibitive interest rate regime, and volatile exchange rate regime. These observations agree with the findings of Olokoyo (1999), Olaniyan (2000), Olaniyan, Olayiwola *et al.* (2001), Akabueze (2002), Okojie (2004) and Osa-Afiana (2004), in the discussion of the problems or range of

difficulties, which are being, or may be, encountered by small and medium scale business units in Nigeria

In general, financial access in developing countries is observed to be much lower compared to that for developed countries, and concentrated among top borrowers. Figure 3.5 shows that financial access for individuals (measured by the ratio of the number of loans per adult) in developed countries is almost four times higher than the average ratio in developing countries. Moreover, in developing countries the average loan amount relative to per capita income is much higher, indicating that credit is much more concentrated among fewer borrowers. The relatively low number of loans to individuals in developing countries to some extent captures SME finance constraints, as many early stage SMEs rely on personal loans to the owner to meet their business needs.

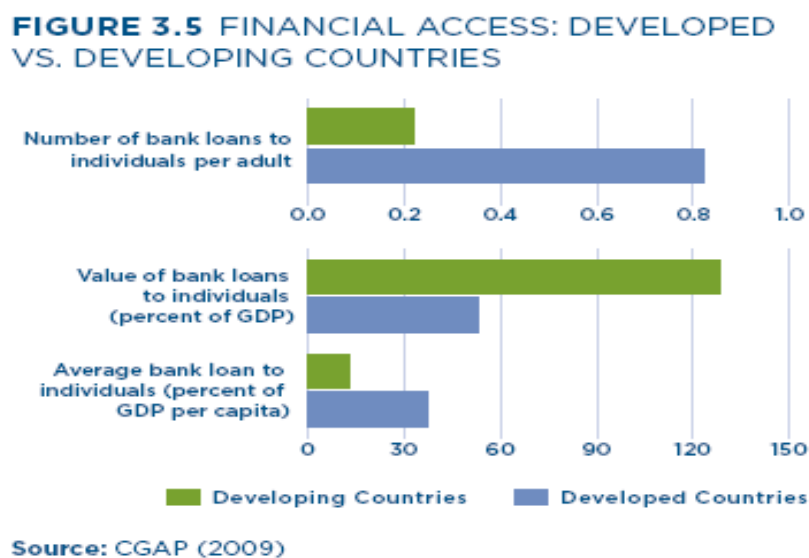


Figure 2.11.1: Financial Access: Developed Vs. Developing Countries

The story of SME Finance is not much different, and Enterprise Surveys conducted by the World Bank in over 120 countries show that SMEs face more severe financing constraints than large firms, especially in lower income environments. As shown in Figure 3.6, only 17 and 32 percent of small firms in low and middle-income countries, respectively, have a loan or line of credit. This ratio is over 50 percent in the case of high income countries. Medium-sized enterprises are also constrained in lower-income settings, although to a lesser degree. Large enterprises are generally much less constrained, even in low and middle-income countries. On average, the likelihood of a small firm having access to a finance in low-

income countries is less than half of what it is for a medium-sized firm, and about a third of what it is for a larger firm.

Until recently, lack of comparable data hampered attempts to study the determinants of financing constraints for SMEs in a cross-country context. The recent availability of data from the WBES has led to a number of studies on the determinants of financing constraints. For the most part, these studies look at the impact on credit constraints of a single explanatory variable (such as foreign bank penetration, bank competition, availability of credit registries, or creditor rights) and do not attempt to bring all the potential determinants together into the analysis.

Clarke, Cull, and Martínez Pería, (2001), for example, investigate the impact of foreign bank penetration on lending to SMEs. They find that foreign bank penetration increases the share of financing from banks and lowers financing obstacles as perceived by firms, particularly in the case of large firms. Love and Mylenko (2003) explore how credit-reporting institutions affect financing constraints. The authors find that private credit registries relax financing constraints and increase bank financing, particularly for SMEs. By contrast, public registries do not have a significant effect. Beck, Demirgüç-Kunt, and Maksimovik (2003) study the impact of bank concentration on firms' financing obstacles and access to credit. They find that in countries with low levels of institutional development, bank concentration leads to higher obstacles and a lower share of bank financing, particularly in the case of SMEs. Finally, Galindo and Micco (2004b) explore the impact of several measures of creditor rights protection on the share of financing from banks. They find that creditor rights increase access to financing by SMEs relative to the effects on large firms.

2.12 The gap

Most economic activity in the world comes from the small and medium-sized enterprise (SME) sector (Wendel and Harvey, 2006). Yet in many developing countries, SMEs have limited access to credit. In sub-Saharan Africa, for example, banking-sector penetration is roughly one percent of the population (Stein, 2001). In Kenya, there are about 2.2 million micro, small and medium enterprises (Strategic Business Advisors (Africa) Ltd. – *SME Banking Sector Report, 2007*), of which 88 percent are non-registered. Of this non-registered group, only 23 percent have bank accounts, and only 10 percent have ever received credit

from any formal source. Small and Medium Enterprises (SMEs) have become an important sector in the Kenyan economy, becoming a major employer for the labour force in the country. Policy makers in Kenya expect micro and small enterprises to provide the bulk of new jobs created in the economy yet these enterprises face significant credit constraints (Daniels et al, 1995). Despite their proliferation, SMEs continue to face a number of constraints, like lack of credit, which limit their development. Egbert (2004) notes that in many developing countries, SMEs have to deal with characteristics of their firms , awareness of MFIs requirements and credit policies of MFIs to obtain credit hence there importance to determine the extent to which the factors affecting access of credit by small and medium enterprises (SMEs) in microfinance in Nakuru.

2.13 Conceptual Framework

The conceptual framework for this study considers credit accessibility as a critical component of SMEs growth and performance. The conceptual framework recognizes the independent variables of the study which are assessed through the various elements of factors affecting credit accessibility by SMEs from MFIs namely: Characteristics of the firm, collateral and credit policies. On the other hand, credit accessibility is considered to be the dependent variables assessed in terms of indicators such as number of times SMEs accessed credit and number of SMEs that accessed credit facilities. In this conceptual framework, the external environment of an organization is considered essential in determining the attainment of credit accessibility. In this study, the moderating factors include; government financial regulations and MFIs regulations. The conceptual framework for this study is illustrated in the Figure 2.13

Conceptual Frame Work

Independent variables

- **Characteristics of the SMEs**
 - Age of the Firm
 - Size of the firm
 - Ownership type of the firm
 - Industry sector
 - Location of the firm
- **Awareness MFIS Requirements**
 - Financial statements
 - Credit scoring
- **Credit Policies**
 - Past lending History
 - Cost of Lending
 - Lack of Training
 - collateral

Dependent Variable

- ACCESS OF CREDIT IN MFIS**
 - *Number of times SMEs granted loans*
 - *Number. of SMEs applied and were granted credit*

- MFIs Regulations
- Government Regulations

Moderating variables

Figure 2.13.1: Relationship between Factors Affecting Credit Accessibility by SMEs
Source: Researcher - Adaptation from Reviewed Literature, 2013

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Design

The study employed conventional research design to investigate the factors affecting access of credit to SMEs in MFIs. Surveys are frequently conducted for the purpose of making descriptive assertions about a population, which is discovering the distribution of certain traits or attributes (Babbie, 1990).

3.2 Study Population

The target population for this study were SMEs doing business in Boutiques, saloons, cosmetic shops and hardwares in Nakuru municipality. From, data collected from the Municipal Council licensing department, 620 such business were in municipality as at 16/1/2013 (See Appendix 3). These constituted the study population.

3.3 Sampling Procedures and Sample Size

The sample size for the study was 244, which is determined through sample size formula by Krejcie et al, (1970).

$$n = \frac{N}{1 + N(e)^2}$$

Where

- n** is the sample size,
- N** is the population size, and
- e** is the level of precision.

In this study N is 620, ±5% Precision Levels where Confidence Level is 95%.

$$n = 620 / (1 + 620 * 0.05^2) = 243.137$$

Therefore, the sample size will be 244. To determine the sample size per stratum, the following formula was used.

$$n_i = \frac{N_i * n}{N}$$

Where;

n_i – sample size of the stratum

n- Sample of the total Population

N_i – population in the stratum

N- Total population of the study

Due to time constraint, the study stratified the respondents in four categories which included;

	Population, N_i	Sample, n_i
Boutique	180	71
Salons	90	35
Hardwares	150	59
Cosmetics	200	79
Total	620	244

3.4 Data Collection Instruments and Procedure

The study employed the structured questionnaire as an instrument of data collection since it offers a cheaper, more convenient way of obtaining information from large numbers of people over a wide geographical area. A likert type scale was used to collect information on evaluation of factors affecting credit accessibility of SMEs from MFIs. This is aimed at collecting opinions and views from a cross range of issues from respondents in the SMEs sector. Permission was sought from relevant authorities to undertake this research. At the onset of data collection, the respondents were consulted in order to facilitate a seamless data collection process. It was ensured that the questionnaires are accurately completed during the field work. The questionnaires were numbered and coded to ensure that all the necessary information is recorded. When coding the data any questionnaire which might not have been collected was identified and the anomaly corrected. The questionnaires were self-administered thus the respondents were asked to complete the questionnaires themselves. Owners who were in charge of the SMES were issued with the questionnaires since they were in a better position to give in-depth information concerning the access to credit from MFIs.

3.5 Reliability and Validity

Validity refers to the extent to which the instrument collects data that it is meant to collect. It is the degree to which results obtained from the analysis of the data actually represent the phenomenon under study. In this study, ensuring validity of the data collection instrument involved going through the questionnaire in relation to the set objectives and making sure that they contain all the information that can enable answer these objectives.

Reliability measures the degree to which a research instrument yields consistent results or data after repeated trials. To ensure reliability, the questionnaire was pre-tested on a few selected respondents in the study area. In this study a reliability co-efficient (Alpha value) of more than 0.7 was assumed to reflect the acceptable reliability. The Alpha value ranges from zero to one and indicates the reliability of an instrument. The more the Alpha value is closer to one, the more reliable the instrument. The objective of pre-testing is to allow for modifications of various questions in order to rephrase, clarify and clear up any shortcomings in the questionnaire.

3.6 Data Analysis and Presentation

Descriptive and inferential statistics were used to analyze the various variables. The information was presented in form of table, charts and narrative form. Primary data was analyzed with the help of the Statistical Package for Social Sciences (SPSS) computer software (version 17.0).

In this study, correlation and regression analysis were used to determine the strength and direction of association between factors affecting credit accessibility and accessibility of credit. In all cases, correlation analysis was tested at $p < 0.05$ significance levels (2-tailed test), as conventionally applied in social science surveys. The technique is based on the linear equation model expressed as:

$$Y = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + \dots\dots\dots b_nX_n + \text{Error.}$$

Where Y= dependent variable – Accessibility of credit (No of times SMEs granted loans No. of SMEs applied and were granted credit)

b_0 = constant

b_1, b_2, b_3, b_n = correlation coefficient

$x_1, x_2, x_3 \dots x_n$ = independent variables (Characteristics of the firm, Awareness of MFIs requirements and Credit policies of MFIs)

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION

4.1 Introduction

The research set to evaluate factors affecting access to credit by SMEs from MFIs within Nakuru Municipality, Kenya. The research sought to address the following research objectives:

- i. To determine the extent to which SMEs characteristics affect accessibility to credit offered by MFIS
- ii. To determine the extent to which awareness of MFIs requirements affects accessibility to credit by SMEs
- iii. To evaluate whether credit policies of MFIs affect accessibility to credit by SMEs

The results of data analysis are presented and discussed as follows:

4.2 Description of the Research Sample

This section presents a brief description of the demographic characteristics of the sampled respondents and the profile of the sampled SMEs in this research. Such a description is considered to be very important in providing a better understanding of the respondents included in the research and therefore provide a good foundation for a detailed discussion of the results based on the stipulated objectives of the research.

4.2.1 Type of Sampled Business Operated

The research assessed the types of SME businesses within the research area. The research sample (Table 4.2.1), revealed that 32.38% were cosmetics, 29.10% of businesses were Boutiques, 24.18% were hardwares, while 14.34% were Salons.

Table 4.2.1. Type of business operated

Type	Population	Frequency	Percent of Sample size
Hardware	150	59	24.18
Boutique	180	71	29.10
Salon	90	35	14.34
Cosmetics	200	79	32.38
Total	620	244	100.0

Source: Research Data, (2013)

4.2.2 Distribution of the respondents by Gender

The findings of the research (Table 4.2.2) established that 52% of research respondents were male whereas 48% were females.

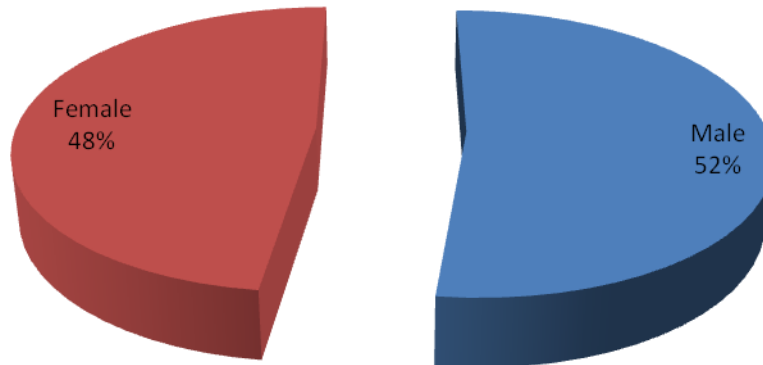


Figure 4.2.2. Distribution of the respondents by Gender

Source: Research Data, (2013)

4.2.3 Age of Business

On the basis of age of business, the research found that 36.1% of the business had operated for 11-15 years, 33.6% had operated for 6-10 years, and 26.6% had existed for 1-5 years while only 3.7% were aged 16-20 years. The number of years in operations is an important factor in influencing the credit accessibility. The results of the research indicated that out of the sampled SMEs only 26.6% had operated for less than five years while 73.4% had operated for six years and above.

Table 4.2.3. Age of Business

Age Group	Frequency	Percent
1-5 yrs	65	26.6
6-10yrs	82	33.6
11-15yrs	88	36.1
16-20yrs	9	3.7
Total	244	100

Source: Research Data, (2013)

4.3 Effect of SMEs Characteristics on Credit Accessibility Offered by MFIs

The main objective of the research was to determine the effect of SMEs characteristics on credit accessibility offered by MFIs. In this regard the research intended to determine the effect of various factors categorized as SME characteristics, awareness of MFIs requirements and credit policies on access to credit. Research findings on various factors were presented in the section below:

4.3.1 Age of the Firm

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicate the extent to which age of the firm affected access to credit offered by MFIs in the research area. The results are tabulated in the Table 4.3.1

Table 4.3.1 Effect of Age of the Firm on Access to Credit

Statement	Percentage Response (%)					Total
	Not at all	To a low extent	To some extent	To a greater extent	To a very great extent	
Stable growth of the firm over the years is critical in influencing credit accessibility from MFIs	5.2	7.4	38.5	37.8	11.1	100.0
Track record of the firm activities is important in determining credit worthiness of your firm	0.3	5.3	36.6	44.3	13.5	100.0
Legitimacy and trust of your firm by MFIs increases with the number of years your firm has been in operation	0.8	6.6	35.2	45.1	12.3	100.0

Source: Research Data, (2013)

On the extent to which age of the firm influenced credit accessibility the research revealed that 45.9% of the respondents generally reported that stable growth of the firm over the years was critical in influencing credit accessibility from MFIs to some extent, 48.9% to a great extent while 5.2% reported not at all. In addition 57.8% of the respondents generally reported that track record of the firm activities was important in determining credit worthiness of your

firm to a great extent, 41.9% generally to some extent while 0.3% reported not at all. The research results further showed that 57.4% of the respondents generally reported that stable legitimacy and trust of the firm by MFIs increased with the number of years the firm has been in operation to great extent, 41.8% to some extent while 0.8% reported not at all.

On the extent to age of the firm affected access to credit offered by MFIs, survey data (Figure 4.3.1) showed that 56.6% of respondents reported moderately, 30.7% reported “high” whereas only 12.7% reported “low”. It is evident from the results that age of the firm significantly affected access to credit offered by MFIs.

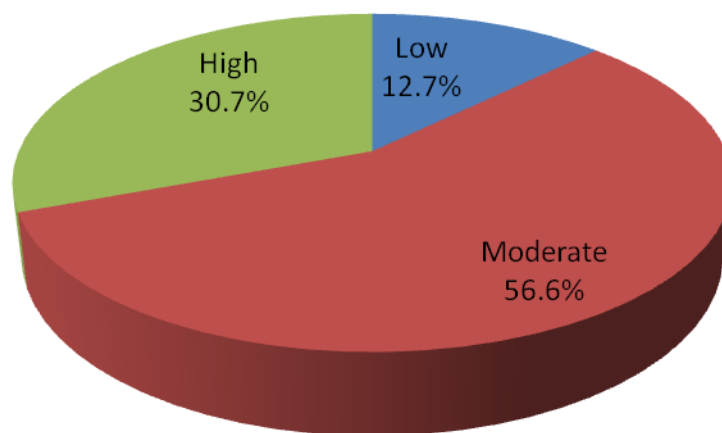


Figure 4.3.1; Overall Age of Firm Index

Source: Research Data, (2013)

4.3.2 Size of the Firm and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated extent to which size of the firm affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.3.2.

Table 4.3.2 Effect of Size of the firm on Access to Credit

Statements	Percentage Response (%)					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
Business viability of the firm is important in influencing credit accessibility from MFIS	0.0	6.1	41.4	46.3	6.2	100.0
Good market share of the firm increase credit worthiness from MFIs	0.8	4.1	41.4	44.3	9.4	100.0
Larger firms (SMEs) are well placed to provide the requisite securities required by MFIs	0.0	5.7	29.1	54.5	10.7	100.0

Source: Research Data, (2013)

The research found out that 52.5% of the respondents reported that business viability of the firm was generally to a great extent important in influencing credit accessibility from MFIS, 47.5% reported to some extent, while none of the respondents reported to none at all.

Further, 53.7% of the respondents reported that good market share of the firm generally to great extent increased credit worthiness from MFIs, 45.5% reported to some extent while 0.8% reported not at all. In addition, 65.2% of the respondents reported that larger firms (SMEs) were to great extent well placed to provide the requisite securities required by MFIs, 34.8% reported to some extent while none reported not at all.

Survey data on extent to which size of firm affected access to credit shows that 63.5% of the respondents reported moderate, 13.1% reported “high” and 23.4% reported “low”. Figure 4.3.2 the research findings point out that size of firm significantly affected access to credit by offered by MFIs.

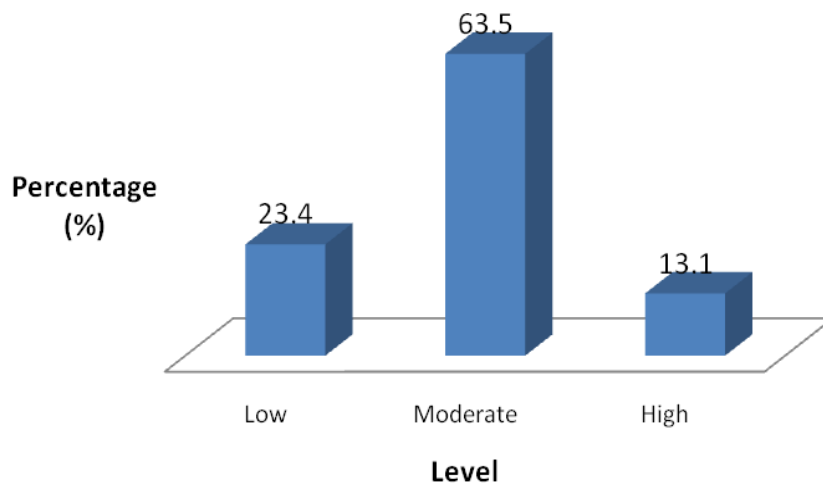


Figure 4.3.2 Overall Size of the Firm Index

Source: Research Data, (2013)

4.3.3 Ownership of the Firm and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated the extent to which ownership of the firm affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.3.3.

Table 4.3.3 Effect of Ownership of the Firm on Access to Credit

Statements	Percentage Response (%)					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
SMEs owned by group of people are able to provide Adequate guarantee to access credit	5.7	5.7	38.1	42.2	8.2	100.0
Single or family owned SMEs are considered to have unpredictable future operations hence difficult to access credit from MFIs	43.0	11.9	35.2	6.6	3.3	100.0

Source: Research Data, (2013)

The research findings indicated that, 50.4% of the respondents reported that SMEs owned by group of people were to a great extent able to provide adequate guarantee to access credit, 43.8% reported to some extent while 5.8% reported not at all. Further, the research findings indicated that 47.1% of the respondents reported that single or family owned SMEs were to a some extent able to provide adequate guarantee to access credit, 9.9% reported to a great extent while 43.0% reported not at all.

Survey data on the extent to which ownership of the firm affected access to credit (Figure 4.3.3) show that 62% of respondents reported moderate, 25% reported low and 13% reported high. Overall, the research points out that ownership of the firm significantly affected access to credit.

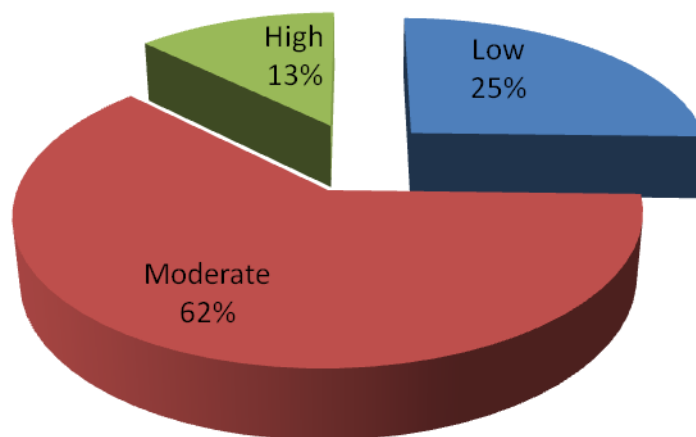


Figure 4.3.3 Overall Ownership of Firm Index

Source: Research Data, (2013)

4.3.4 Industry Sector of the Firm and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated extent to which industry sector of the firm affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.3.4.

Table 4.3.4 Effect of Industry sector of the Firm on Access to Credit

Statements	Percentage Response (%)					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
Firms (SMEs) in risky industry sectors are least considered by MFIs on issuance of credit facilities	1.2	9.0	48.4	38.1	3.3	100.0
Firms in industry sectors with low survival rates have difficulties obtaining loans from MFIs	0.4	5.7	38.1	49.2	6.6	100.0
Firms in industry sectors with stiff Competition are less viable for credit facilities by MFIs	2.0	4.1	52.9	36.9	4.1	100.0

Source: Research Data, (2013)

The research revealed that 57.4% of the respondents reported that firms (SMEs) in risky industry sectors were to some extent least considered by MFIs on issuance of credit facilities, 41.4% reported to great extent while 1.2% reported not at all. Also, 55.8% of the respondents reported that firms in industry sectors with low survival rates to a great extent had difficulties obtaining loans from MFIs, 43.8% reported to some extent while 0.4% reported not at all. In addition, 57% of the respondents reported that firms in industry sectors with stiff competition were to some extent less viable for credit facilities by MFIs, 41% reported to a great extent while 2.0% reported not at all.

On the extent to which industry sector of the firm affected access to credit, research results (Figure 4.3.4) indicate that 77.9% of the respondents reported “moderate”, 20.9% reported high while 1.2% reported “low”. The results of data analysis indicate that the industry sector of the firm significantly affected access to credit offered by firms in the research area.

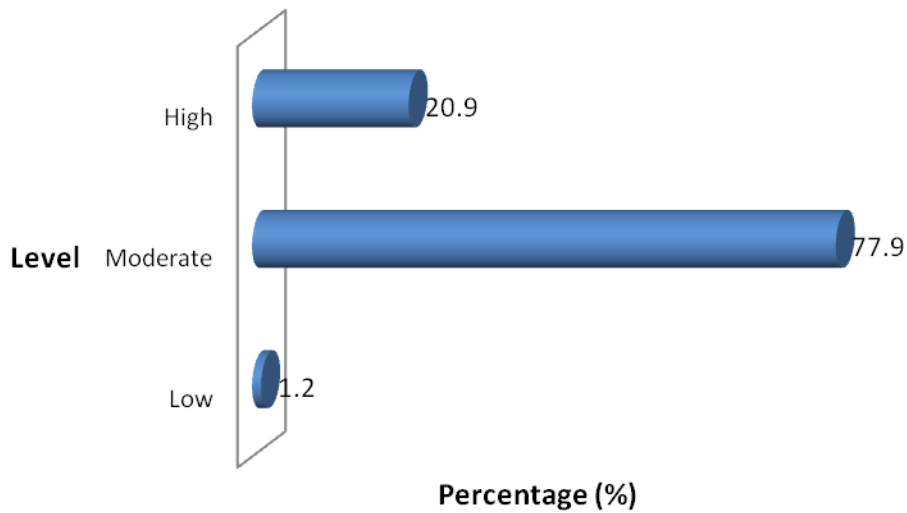


Figure 4.3.4 Overall Industry Sector of Firm Index

Source: Research Data, (2013)

4.3.5 Location of the Firm and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated the extent to which location of the firm affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.3.5.

Table 4.3.5 Effect of Location of the Firm on Access to Credit

Statements	Percentage Response					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
Firms located on busy streets (main) are considered viable for credit facilities by MFIs	38.1	12.3	14.8	17.2	17.6	100.0
Firms in lower floors of a building are considered more viable by MFIs than those at higher floors	43.9	12.3	9.4	16.4	18.0	100.0

Source: Research Data, (2013)

The research revealed that 34.8% of the respondents reported that firms located on busy streets (main) were to a great extent considered viable for credit facilities by MFIs, 27.1% reported to some extent while 38.1% reported not at all. In addition, research results revealed

that 34.4% of the respondents reported that firms in lower floors of a building were to a great extent considered more viable by MFIs than those at higher floors, 21.7% reported to some extent while 43.9% reported not at all.

On the extent to which location of the firm affected access to credit, survey data (Figure 4.3.5) indicate that 50.8% of the respondents reported “low”, 31.1% reported high while 18% reported “moderate”. The research concludes that location of the firm was found not to significantly affected access to credit

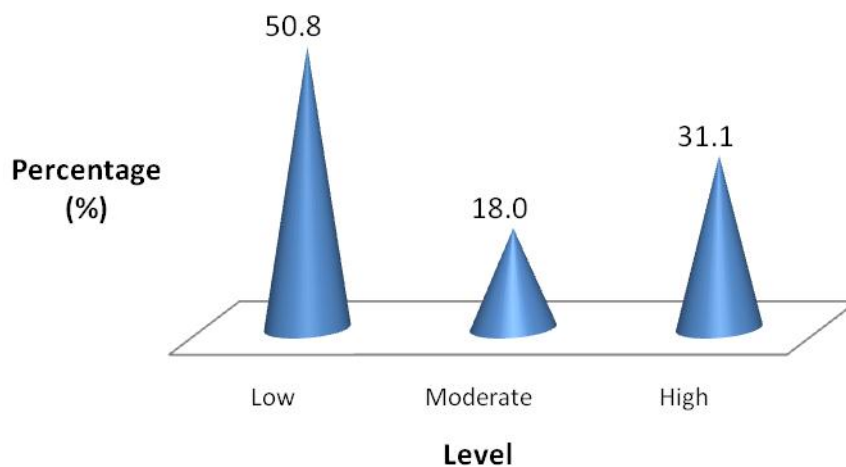


Figure 4.3.5 Overall Location of Firm Index

Source: Research Data, (2013)

4.4 Effect of Awareness of MFIs Requirements on Credit Accessibility Offered by MFIs

Objective two of the research intended to determine the extent to which awareness of MFIs requirements affects credit accessibility by SMEs. Research results on various aspects of MFIs requirements were presented in the section below:

4.4.1 Financial Statements and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated the extent to which financial statement affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.4.1.

Table 4.4.1. Effect of Financial Statements on Access to Credit

Statements	Percentage Response (%)					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
The firms (SMEs) with audited financial statements are highly rated by MFIs on issuance of credit facilities	0.4	0.8	28.7	53.7	16.4	100.0
Firms that adherence to Legal requirement (filing of tax returns and publishing of financial statements,) are considered credit worthy by MFIS	0.8	2.5	20.5	45.1	31.1	100.0

Source: Research Data, (2013)

Survey data shows 70.1% of respondents reported that the firms (SMEs) with audited financial statements were to a great extent highly rated by MFIs on issuance of credit 29.5% reported to some extent while 0.4% reported not at all. Also, 76.2% of the respondents reported that firms that adherence to legal requirement (filing of tax returns and publishing of financial statements) were to a great extent considered credit worthy by MFIS, 23% reported to some extent while 0.8% reported not at all.

Figure 4.4.1 indicates that 61% of the respondents reported that the financial statements moderately affected access to credit, 35% reported high and only 4% reported that financial statements affected access to credit to a low extent. The research concluded that financial statements significantly affected access to credit offered by MFIs in the research area.

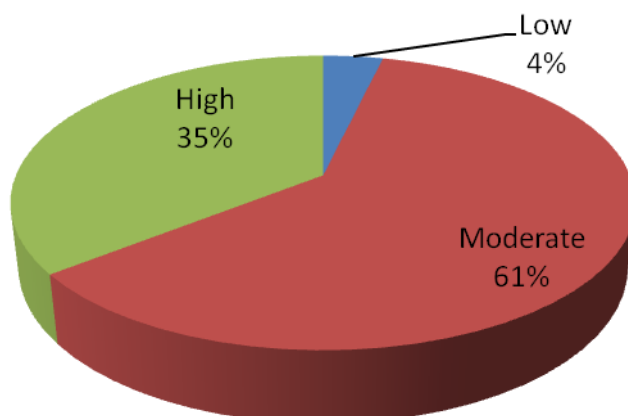


Figure 4.4.1 Overall Financial Statement Index

Source: Research Data, (2013)

4.4.2. Credit Scoring and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated extent to which credit scoring affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.4.2.

Table 4.4.2 Effect of Credit Scoring on Access to Credit

Statements	Percentage Response (%)					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
Terms and conditions of loans offered by MFIs results to low loan application by SMEs	2.5	4.9	54.5	29.9	8.2	100.0
Short duration of the loans and strict terms of payment offered to SMEs by MFIs affects the rate of loans applied for.	2.5	4.9	51.2	38.1	3.3	100.0
Firms Lack of information clarity on nature and terms of credit facilities offered by MFIs results to low application for credit facilities	4.1	7.0	41.4	43.9	3.7	100.0

Source: Research Data, (2013)

Research results showed that in 59.4% of the respondents generally reported that terms and conditions of loans offered by MFIs to some extent resulted to low loan application by SMEs, 38.1% reported to great extent while 2.5% reported not at all. Further, 56.1% of the respondents generally reported that short duration of the loans and strict terms of payment offered to SMEs by MFIs to some extent affected the rate of loans applied for, 41.1% reported to a great extent while 2.5% reported not at all. Also, 48.3% of the respondents generally reported that firms lack of information clarity on nature and terms of credit facilities offered by MFIs to some extent resulted to low application for credit 47.6% reported to a great extent while 4.1% reported not at all.

On the extent to which credit scoring of the firm affected access to credit, research results (Figure 4.4.2) indicate that 49.6% of the respondents reported moderately, 45.1% reported high while 5.3% reported to a low extent. These results generally indicate that credit scoring of the firm of the firm significantly affected access to credit offered by firms in the research area.

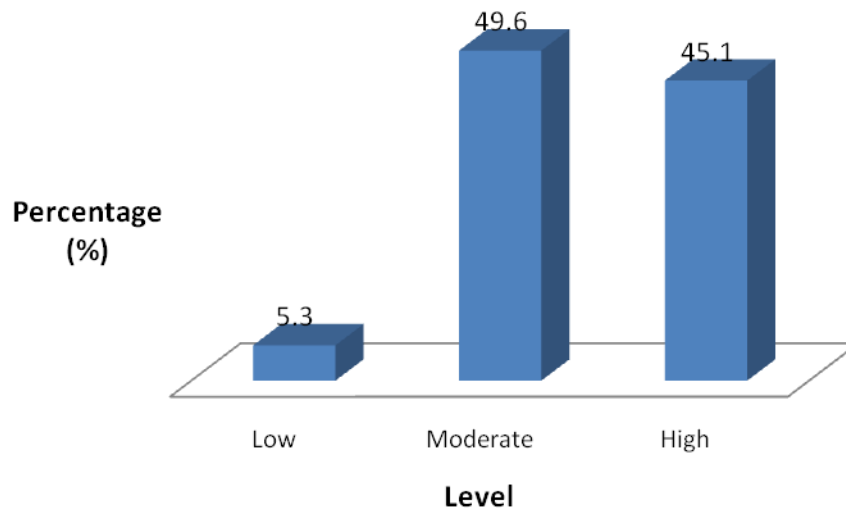


Figure 4.4.2. Overall Credit Scoring Index

Source: Research Data, (2013)

4.5 Effect of Credit Policies on Access to Credit

The research intended to evaluate the extent to which credit policies affected access to credit offered by MFIs to SMEs in the research area. Research results on various aspects of credit policies such as: Past lending history; Cost of lending, Lack of training and Collateral were presented in the section below:

4.5.1. Past Credit Lending History and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated extent to which past lending history affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.5.1.

Table 4.5.1. Effect of Past Lending history on Access to Credit

Statements	Percentage Response (%)					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
Firms with high rate of defaults in previous loans rarely obtain more loans from MFIs	6.6	9.0	28.7	45.9	9.8	100.0
Firms which delay repayments of loans will face harsh conditions when seeking credit facilities from MFIs	1.2	9.0	23.0	52.5	14.3	100.0

Source: Research Data, (2013)

The research revealed that 55.7% of the respondents generally reported that the firms with high rate of defaults in previous loans to a great extent rarely obtained more loans from MFIs, 38.7% reported to some extent while 6.6% reported not at all. In addition, 66.8% of the respondents generally reported that the firms which delayed repayments of loans to a greater extent faced harsh conditions when seeking credit from MFIs, 32% reported to some extent while 1.2% reported not at all.

On the extent to which past lending history of the firm affected access to credit, research findings (Figure 4.5.1) indicate that 50% of the respondents reported moderately, 45% reported high while 5% reported to a low extent. These results of research data generally indicate that past lending history of the firm significantly affected access to credit offered by firms in the research area.

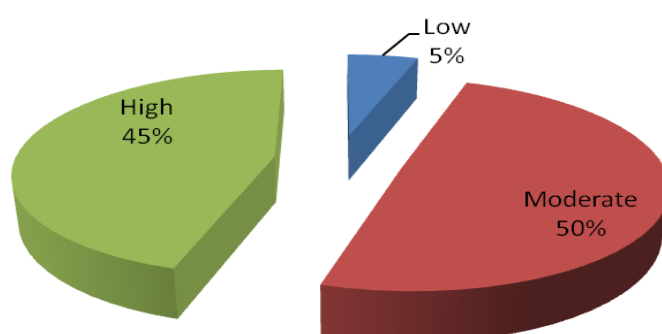


Figure 4.5.1 Overall Past Lending History Index

Source: Research Data, (2013)

4.5.2 Cost of Lending and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated extent to which cost of lending affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.5. 2.

Table 4.5.2 Effect of Cost of Lending on Access to Credit

Statements	Percentage Response (%)					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
The high interest rates on loans offered by MFIs makes SMEs shy away from seeking credit facilities	1.6	4.1	43.4	45.9	4.9	100.0
Complicated application procedures for loans from MFIs makes SMEs shy away	3.7	3.7	52.0	36.5	4.1	100.0
Loan application costs charged by MFIs results to low application for credit facilities by SMEs	2.9	2.5	56.6	36.1	2.0	100.0

Source: Research Data, (2013)

The research revealed that 50.8% of the respondents generally reported that the high interest rates on loans offered by MFIs to a great extent made SMEs shy away from seeking credit facilities, 47.6% reported to some extent while 1.6% reported not at all. In addition, 55.7% of the respondents generally reported that the complicated application procedures for loans from MFIs to some extent made SMEs shy away, 40.6% reported to a great extent while 3.7% reported not at all. In addition the research results indicated that only 59.1% of the respondents generally reported that loan application costs charged by MFIs to some extent resulted to low application for credit facilities by SMEs, 38% reported to a great extent while 2.9% reported not at all.

Survey data on the extent to which cost of lending affected access to credit (Figure 4.5.2) revealed that 77% of the respondents reported moderate, 18.5% reported high whereas only 4.5% reported low. The research concluded that cost of lending significantly affected access to credit

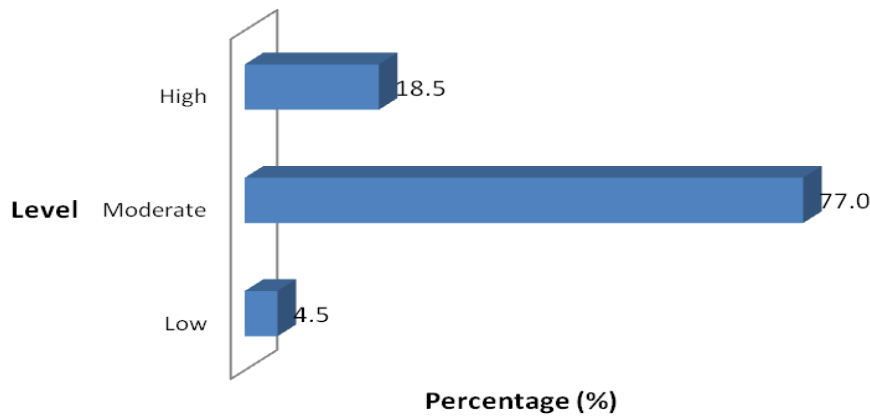


Figure 4.5.2 Overall Cost of Lending Index

Source: Research Data, (2013)

4.5.3 Lack of Training and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated extent to which lack of training affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.5.3.

Table 4.5.3 Effect of Lack of Training on Access to Credit

Statements	Percentage Response					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
SMEs lack of training on Credit funds management deters them from applying of credit facilities offered by MFIs	2.0	5.3	59.4	32.0	1.2	100.0
Firms lack of training on cost of loans results to low application of credit facilities from MFIs	1.6	3.7	47.1	43.9	3.7	100.0

Source: Research Data, (2013)

The research revealed that 64.7% of the respondents generally reported that SMEs lack of training on Credit funds management to some extent deterred them from applying of credit offered by MFIs, 33.3% reported to a great extent while 2% reported not at all. Also, 50.8% of the respondents generally reported that firms lack of training on cost of loans to some extent resulted in low application of credit facilities from MFIs, 47.6% reported while 1.6% reported not at all.

Survey data on the extent to which lack of training affected access to credit Figure 4.5.3 revealed that 63% of the respondents reported high, 32% reported moderately whereas only 5% reported low. The research concludes that lack of training significantly affected access to credit .

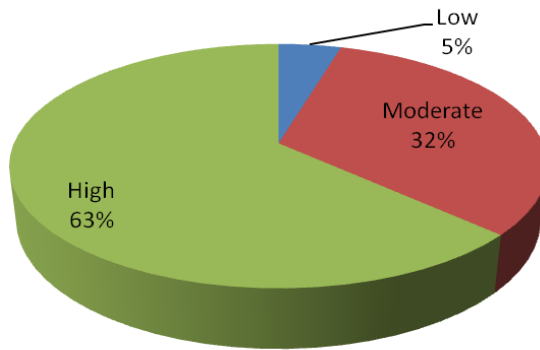


Figure 4.5.3 Overall Lack of Training Index

Source: Research Data, (2013)

4.5.4 Collateral and Access to Credit

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents indicated extent to which collateral affected access to credit offered by MFIs in the research area. The results are tabulated in Table 4.5.4.

Table 4.5.4 Effect of Collateral on Access to Credit

Statements	Percentage Response (%)					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
Properties with ownership documents are highly acceptable than those without by MFIs	0.4	2.9	30.8	43.4	22.5	100.0
Properties with high value than amount of loans applied for are highly acceptable by MFIs on issuance of credit facilities	2.0	0.8	27.9	42.3	27.0	100.0
The ease of capability to sell the assets offered as collateral is considered vital by MFIs on issuance of credit facilities	9.4	3.3	21.7	44.7	20.9	100.0
Properties with ownership documents are highly acceptable than those without by MFIs	0.0	2.5	20.9	53.3	23.3	100.0

Source: Research Data, (2013)

The research revealed that 65.9% of the respondents generally reported that properties with ownership documents to a great extent were highly acceptable than those without by MFIs, 33.7% reported to some extent while 0.4% reported not at all. Also, 69.2% of the respondents generally agreed that properties with high value than amount of loans applied for to a great extent were highly acceptable by MFIs on issuance of credit 28.7% reported to some extent while 2% reported not at all. In addition, 65.6% of the respondents generally reported that the ease of capability to sell the assets offered as collateral to a great extent was considered vital by MFIs on issuance of credit, 25% reported to some extent while 9.4% reported not at all. Finally, 76.6% of the respondents generally reported that properties with ownership documents to a great extent were highly acceptable than those without by MFIs, 23.4% reported to some extent while none reported not at all

Survey data on extent to which collateral affected access to credit Figure 4.5.4 revealed that 49.2% of the respondents reported high, 45.5% reported moderately whereas only 5.3% reported low. The research concluded that collateral significantly affected access to credit

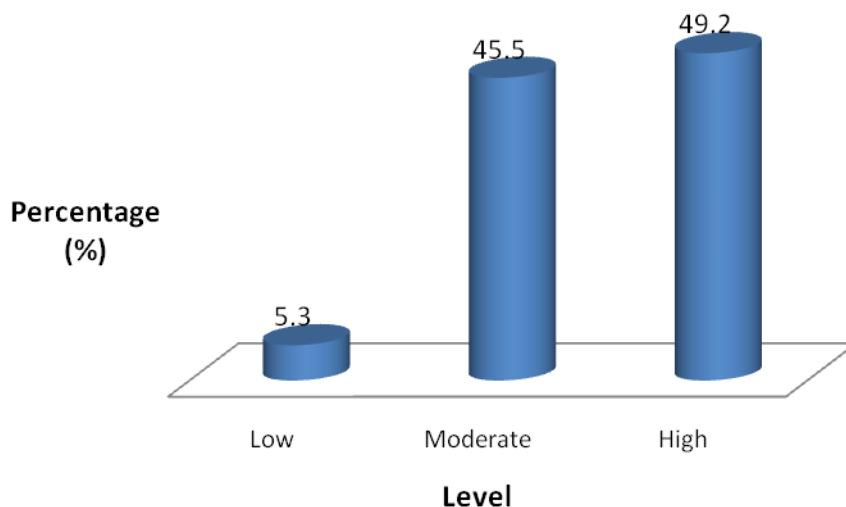


Figure 4.5.4 Overall Collateral Index

Source: Research Data, (2013)

4.6 Accessibility to Credit from MFIs by SMEs

Through a five likert point scale with very great extent, great extent, some extent, to a low extent and not at all the respondents were asked to indicate the extent of access to credit by SMEs offered by the MFIs in the research area. The results are tabulated in Table 4.6.

Table 4.6.1 Access of Credit by SMEs

Statements	Percentage Response (%)					Total
	Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent	
SMEs obtain loans immediately when they applied from MFIs	18.0	22.6	41.0	16.8	1.6	100.0
SMEs were issued with loans every time they applied fro from MFIs	29.5	13.9	42.6	13.5	0.5	100.0

Source: Research Data, (2013)

Research revealed that in 63.5% of the respondents generally reported that to some extent SMEs obtained loans immediately when they applied from MFIs, 18.4% reported to great extent while 18% reported that the firms did not access credit at all. Further, 56.5% of the respondents generally reported that to some extent SMEs were issued with loans every time they applied fro from MFIs, 14% reported to great extent while 29.5% reported that the firms did not access credit at all.

Figure 4.6 indicates that 39% of the respondents reported that the overall level of access to credit by the firms was generally low, 37% reported moderate and only 24% reported low. On the basis of these results, the overall level of access to credit by the firms was found to be insignificant in the research area.

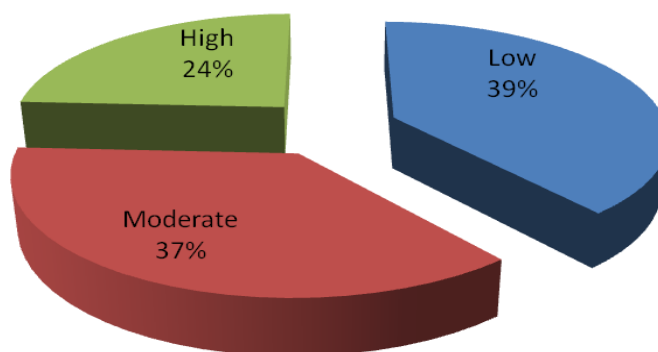


Figure 4.6.1 Overall Access to Credit Index

Source: Research Data, (2013)

4.7 Hypothesis Testing

The broad objective of this research was to determine the effects of SMEs characteristics, awareness of MFIs requirements and credit policies of MFIs on SME's access to credit offered by MFIs in the research area. In order to achieve this, the research sought to test the following null hypotheses:

H₀₁: The SMEs characteristics did not significantly affect accessibility to credit offered by MFIS

H₀₂: Awareness of MFIs requirements did not significantly affect accessibility to credit by SMEs

H₀₃: The credit policies of MFIs did not significantly affect accessibility to credit by SMEs.

4.7.1 Correlation Analysis

In order to test the research hypotheses, correlation analysis was done in which the computed scores of the various factors (SMEs characteristics, awareness of MFIs requirements and credit policies of MFIs) were correlated to overall computed scores of access to credit. The results of correlations analysis were summarized in Table 4.7.1.

Table 4.7.1 Correlation Analysis Results

Independent Variables	Statistics	Dependent Variables (Access to Credit)
<u>SME Characteristics</u>		
Age of the Firm	Correlation Coefficient (r)	.173**
	Significance Level (p-value)	.000
Size of the Firm	Correlation Coefficient	.165**
	Significance Level (p-value)	.010
Ownership of the Firm	Correlation Coefficient	.217**
	Significance Level (p-value)	.001
Industry sector of the Firm	Correlation Coefficient	.150*
	Significance Level (p-value)	.019
Location of the firm	Correlation Coefficient	.301*
	Significance Level (p-value)	.000
Combined SMEs Characteristics	Correlation Coefficient	.342**
	Significance Level (p-value)	.000
<u>MFIs Requirements</u>		
Financial Statement	Correlation Coefficient	.024
	Significance Level (p-value)	.713
Credit Scoring	Correlation Coefficient	-.426**
	Significance Level (p-value)	.000
Combined MFIs Requirements	Correlation Coefficient	-.326**
	Significance Level (p-value)	.000
<u>Credit Policies</u>		
Past Credit Lending History	Correlation Coefficient	-.425**
	Significance Level (p-value)	.000
Cost of lending	Correlation Coefficient	-.340**
	Significance Level (p-value)	.000
Lack of training	Correlation Coefficient	-.317**
	Significance Level (p-value)	.000
Collateral	Correlation Coefficient	.139*
	Significance Level (p-value)	.031
Combined Credit Policies	Correlation Coefficient	-.340**
	Significance Level (p-value)	.000

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

*Correlation is significant at the 0.05 level (2-tailed).

Source: Research Data, (2013)

4.7.1.1 Effect of SMEs Characteristics on Credit Accessibility Facilities Offered by MFIS

According to the correlation results on Table 4.7.1, age of the firm was found to be significantly associated to access to credit by SMEs ($r = 0.173$, $P < 0.05$). Further, research results revealed that size of the firm was found to be significantly associated to access to credit by SMEs ($r = 0.165$, $P < 0.05$).

In addition, research results reveal that ownership of the firm was found to be significantly associated to access to credit by SMEs ($r = 0.217, P < 0.05$). The results also indicated that industry sector of the firm was found to be significantly associated to access to credit ($r = 0.150, P < 0.05$). Finally, research results indicate that location of the firm was found to be significantly associated to access to credit by SMEs ($r = 0.301, P < 0.05$).

Correlation analysis results also indicate that the combined effect of SMEs characteristics on access to credit was found to be positive and significant ($r = 0.342, P < 0.05$). This implies that the SMEs characteristics positively influenced access to credit offered by the MFIs in the research area.

4.7.1.2 Effect of MFIs Requirements on Credit Accessibility Facilities Offered by MFIS

According to the correlation results (Table 4.7.1), financial statements was not found to be significantly associated to access to credit by SMEs ($r = 0.024, P > 0.05$). Further, the results revealed that credit scoring was found to be negatively and significantly associated to access to credit by SMEs ($r = - 0.426, P < 0.05$).

Correlation analysis results also indicate that the combined effect of MFIs requirements on access to credit was found to be negative and significant ($r = - 0.326, P < 0.05$). This implies that the MFIs requirements negatively influenced access to credit offered by the MFIs in the research area.

4.7.1.3 Effect of Credit Policies on Credit Accessibility Facilities Offered by MFIs

Correlation results on Table 4.7.1 indicates that past lending history was found to be negatively and significantly associated to access to credit by SMEs ($r = - 0.425, P < 0.05$). This implies that the past lending history negatively affected access to credit by the SMEs. In addition, research results revealed that the cost of lending was found to be negatively and significantly associated to access to credit by SMEs ($r = -0.340, P < 0.05$). This implies that the cost of lending negatively affected access to credit by the SMEs.

Further, research results revealed that lack of training was found to be negatively and significantly associated to access to credit by SMEs ($r = - 0.317, P < 0.05$). This means that cost of lending negatively affected access to credit by the SMEs. Results also indicate that collateral was found to be positively and significantly associated to access to credit ($r = 0.139, P < 0.05$). This indicates that the availability of collateral positively affected access to credit by SMEs.

Correlation analysis results also indicate that the combined effect of credit policies on access to credit was found to be negative and significant ($r = - 0.340, P < 0.05$). This implies that the credit policies negatively influenced access to credit offered by the MFIs in the research area.

4.7.2 Regression Analysis

Regression analysis was carried out to determine the extent to which the factors affected access to credit. In this regard, the overall computed scores of the various factors (SMES characteristics, MFIs requirements and credit policies) were regressed on access to credit. The results of regression analysis were summarized in Table 4.7.2.

Table 4.7.2 Regression Analysis Results

Model		Un-standardized Coefficients		Standardized Coefficients	T	Sig. (p-value)
		B	Std. Error	Beta		
1	(Constant)	6.712	1.346		4.987	.000
	Age of Firm	-.035	.072	-.039	-.480	.632
	Size of Firm	.282	.090	.261	3.136	.002
	Ownership of Firm	.091	.082	.082	1.100	.272
	Sector of Firm	.097	.069	.083	1.414	.159
	Location of Firm	.118	.055	.192	2.161	.032
	Financial statement	-.090	.098	-.062	-.913	.362
	Lending history of	-.329	.093	-.326	-3.549	.000
	Lending cost of Firm	-.054	.095	-.052	-.568	.571
	Lack of training	-.029	.147	-.018	-.195	.846
	Collateral	-.149	.061	-.187	-2.419	.016

a. Dependent Variable: Access to credit Computed

Source: Research Data, (2013)

On the basis of the level of significant (p-values) the following factors were found to significantly affect access to credit by SMEs: Size of the firm (P= 0.002, P <0.05), Location of the firm (P= 0.032, P <0.05), past lending history (P= 0.000, P < 0.05) and collateral (P= 0.016, P < 0.05). The other factors were not found to significantly affect access to credit namely: Age of the firm (P= 0.632, P > 0.05), ownership of firm (P= 0.272, P > 0.05), industry sector of firm (P= 0.159, P > 0.05), financial statement (P= 0.362, P > 0.05), cost of lending (P= 0.571, P > 0.05) and lack of training (P= 0.846, P > 0.05). The research results concluded the following model on the factors affecting access of credit by SMEs in MFIs;

$$Y=6.712+ 0.261X_1+0.192X_2-0.326X_3- 0.187X_4+1.346$$

Where

X₁= Size of the Firm

X₂= Location of the firm

X₃= Lending history of the firm

X₄= Collateral

Results of regression analysis (Table 4.7.2) of the combined factors (SMEs characteristics, MFIs requirements and credit policies) reveal that SMEs characteristics significantly affected access to credit offered by MFIs (P= 0.000, P < 0.05). Hence the null hypothesis that *SMEs characteristics did not significantly affect access to credit offered by MFIs* was rejected.

Findings also indicate that MFIs requirements did not significantly affect sales growth ($P=0.061$, $P > 0.05$). Thus the null hypothesis that *MFIs requirements do not significantly affect access to credit offered by MFIs* was accepted.

Ultimately, findings indicate that credit policies significantly affected access to credit ($P=0.004$, $P < 0.05$). Therefore the null hypothesis that *credit policies do not significantly affect access to credit offered by MFIs* was rejected.

Table 4.7.3 Regression Analysis Results

Model		Un-standardized Coefficients		Standardized Coefficients	t	Sig. (p-value)
		B	Std. Error	Beta		
1	(Constant)	6.906	1.221		5.657	.000
	Combined SME Characteristics	.098	.017	.332	5.884	.000
	Combined MFIs requirements	-.120	.064	-.150	-1.886	.061
	Combined Credit policies	-.101	.035	-.228	-2.872	.004
<i>a. Dependent Variable: Access to credit Computed</i>						

Source: Research Data, (2013)

According to the regression summary model shown on table Table 4.7.4, the co-efficient of determination (R) was 0.509 and $R^2 = 0.259$ or 25.9%. Since R^2 is the portion of the total variation in the dependent variable that is explained in the variation in the independent variable the results confirms that the observed change in access to credit attributed to the factors (SMEs characteristics, MFIs requirements and credit policies) was 25.9% and the remaining percentage may well be explained by other intervening factors.

Table 4.7.4 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.509 ^a	.259	.227	1.63498	.259	8.153	10	233	.000
<i>a. Predictors: (Constant), Collateral, Age of Firm, Sector of Firm, Lending cost of Firm, Financial statement, Ownership of Firm, Size of Firm, Lack of training, Location of Firm, Lending history of Firm</i>									

Source: Research Data, (2013)

CHAPTER FIVE:

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The chapter summarizes the findings of the research, draws conclusion, and gives recommendations that have been derived from the research objectives.

5.2 Summary of Findings

The main objective of the research was to determine the extent to which identified factors (SMEs characteristics, MFIs requirements and Credit policies) affected access to credit offered by MFIs to SMEs in the research area. The research addressed three objectives and tested three research hypotheses using correlation and regression analysis. This section presents a summary of the research results based on the research objectives:

The results of the research revealed that the sampled SME were mainly Cosmetics, Hardware, Boutique and Salon. In addition, results indicated that a significant proportion of the respondents in the research were males compared to females. A survey of the SME business indicated that a large number had been in business for a period between 6-15 yrs.

Objective one of the research intended to determine the extent to which SMEs characteristics (Age, Size, Ownership, Industry sector and Location) affect credit accessibility offered by MFIs. Descriptive results indicated that Age, Size, Ownership, Industry sector of the SMEs significantly affect access to credit offered by MFIs. The results indicated that location of the firm/SME was found to be of no significance to credit access

Objective two of the research intended to determine the extent to which awareness of MFIs requirements affected credit accessibility by SMEs. The research results revealed that, the identified MFIs requirement (Financial statements and Credit scoring) significantly affected access to credit offered by MFIs to SMEs in the research area. Objective three of the research intended to evaluate whether credit policies of MFIs affected credit accessibility by SMEs. The research findings revealed that, the identified credit policies (past lending history and cost of lending) significantly affected access to credit offered by MFIs to SMEs in the research area. Further, it was evident from the results that the credit policies such as lack of training and collateral greatly affected access to credit offered by MFIs to SMEs in the

research area. The research evaluated the level of access to credit offered by MFIs to SMEs. On the basis of the research results, the overall level of access to credit by the firms was generally found to be insignificant in the research area.

Correlation analysis results generally show that the various SME characteristics were positively and significantly related to access to credit. Research results also indicate that the combined effect of SMEs characteristics on access to credit was positive and significant ($r = 0.342, P < 0.05$). This implies that the SMEs characteristics positively influenced access to credit offered by the MFIs in the research area. Furthermore, research results revealed that the combined effect of MFIs requirements on access to credit was found to be negative and significant ($r = - 0.326, P < 0.05$). This implies that the MFIs requirements negatively influenced access to credit offered by the MFIs in the research area. In addition, Correlation analysis results also indicate that the combined effect of credit policies on access to credit was found to be negative and significant ($r = - 0.340, P < 0.05$). This implies that the credit policies negatively influenced access to credit offered by the MFIs in the research area

On the basis of regression analysis results, SMEs characteristics significantly affected access to credit offered by MFIs ($P = 0.000, P < 0.05$). Hence the null hypothesis that *SMEs characteristics did not significantly affect access to credit offered by MFIs* was rejected. Findings also indicate that MFIs requirements did not significantly affect sales growth ($P = 0.061, P > 0.05$) and thus the null hypothesis that *MFIs requirements do not significantly affect access to credit offered by MFIs* was accepted. Finally, findings indicate that credit policies significantly affected access to credit ($P = 0.004, P < 0.05$) and hence the null hypothesis that *credit policies do not significantly affect access to credit offered by MFIs* was rejected.

5.3 Conclusion

On the basis of research results, it can be concluded that the effect of the identified SMEs characteristics on access to credit was established to be positive and significant. This implies that the SMEs characteristics positively influenced access to credit offered by the MFIs in the research area. The results further revealed that the location of the SME was affected access to credit to a low extent. The research concluded that although the SMEs characteristics could positively affect access to credit by SMEs, they had not been fully utilized.

The research results concluded that the effect of MFIs requirements on access to credit was negative and significant. This implies that the MFIs requirements negatively influenced access to credit offered by the MFIs in the research area. Further, it can be concluded that the effect of credit policies on access to credit was found to be negative and significant. This implies that the credit policies negatively influenced access to credit offered by the MFIs in the research area. Overall, it can be concluded that both MFIs requirements and credit policies negatively affected access to credit by SMEs in the research area.

5.4 Recommendations

The research findings noted that the SMEs characteristics had the potential to positively affect access to credit by SMEs, however, they were yet to be entirely exploited to the benefit of the SMEs in the research area. The research thus recommends that the MFIs should seek to transform some of the critical characteristics of SMEs such as size, industry sector and location to their advantage in order to enable SMEs increase access to credit.

It was also noticeable that the effect of MFIs requirements on access to credit was found to be negative and significant. This implies that the MFIs requirements positively influenced access to credit offered by the MFIs in the research area. Consequently, MFIS should endeavour to understand and meet the SMEs requirements for credit such as helping them in preparing financial statements and credit scoring

The research results revealed the association between credit policies and access to credit was negative and significant. This implies that the credit policies negatively influenced access to credit offered by the MFIs in the research area. This research recommends that the MFIs should address the various credit policies such as lack of training, collateral, past lending history and cost of lending in order to increase SMES access to credit through capacity building.

5.5 Suggestion for Further Research

A similar research should be replicated in other parts of Kenya with a view to compare the outcomes. Further research studies should also consider investigating other factors that affect access to credit by SMEs that may not have been covered in this research.

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APPENDIX I: QUESTIONNAIRE

**EVALUATION OF FACTORS AFFECTING ACCESS OF CREDIT BY SMALL AND MEDIUM ENTERPRISES (SMES) IN MICROFINANCE INSTITUTIONS:
A CASE OF NAKURU MUNICIPALITY, KENYA**

INSTRUCTIONS

This questionnaire is designed to obtain information on the Factors affecting access to credit by small and medium enterprises in microfinance institutions in Nakuru Municipality, Kenya. Respondents’ participation will be of great value to the research. All responses will be treated with utmost confidentiality and used only for research purposes. Please ensure that you respond to all the questions. Any additional information may be recorded in a separate paper, if the spaces provided are not adequate.

A. ORGANIZATION’S BACKGROUND INFORMATION

1. Please tick the business you operate?

Hardware	Boutique	Salon	Cosmetic

2. Please indicate your title or designation.....

3. Tick your Gender: Male Female

4. For how long have your been in operation.....

1-5 Years	6-10 Years	11-15 Years	16-20 Years	21-25 Years	26-30 Years	31 years and above

B. Characteristics of the Firm and Credit Accessibility

These are variables related to access to credit, the variables evaluated by MFIs to determine the credit worthiness of a firm.

5. Indicate the extent to which you agree with the following statements concerning the characteristics of your firm and accessibility of credit from MFIS

Please Tick the appropriate box

		No t at all	To a low Exte nt	To some exten t	To a greate r extent	To a very great exten t
		1	2	3	4	5
I	<i>Age of the firm</i>					
	Stable growth of the firm over the years is critical in influencing credit accessibility from MFIS					
	Track record of the firm activities is important in determining credit worthiness of your firm					
	Legitimacy and trust of your firm by MFIS increases with the number of years your firm has been in operation					
II	<i>Size of the firm</i>					
	Business viability of the firm is important in influencing credit accessibility from MFIS					
	Good market share of the firm increase credit worthiness from MFIS					
	Larger firms (SMEs) are well placed to provide the requisite securities required by MFIS					
III	<i>Ownership type of the firm</i>					
	SMEs owned by group of people are able to provide Adequate guarantee to access credit					
	Single or family owned SMEs are considered to have unpredictable future operations hence difficult to access credit from MFIS					
IV	<i>Industry sector of the firm</i>					
	Firms (SMEs) in risky industry sectors are least considered by MFIS on issuance of credit facilities					
	Firms in industry sectors with low survival rates have difficulties obtaining loans from MFIS					
	Firms in industry sectors with stiff Competition are less viable for credit facilities by MFIS					
V	<i>Location of the firm</i>					
	Firms located on busy streets (main) are considered viable for credit facilities by MFIS					
	Firms in lower floors of a building are considered more viable by MFIS than those at higher floors					

C. MFIs Requirements

The procedures required by the MFIs when offering loans. The procedures becomes subject to the approval of loans.

6. Indicate the extent to which you agree or disagree with the following statements concerning MFIs procedures when offering loans?

Please Tick the appropriate box

		No t at all	To a low Exte nt	To some exten t	To a greate r extent	To a very great extent
		1	2	3	4	5
<i>I</i>	Financial Statements					
	The firms (SMEs) with audited financial statements are highly rated by MFIs on issuance of credit facilities					
	Firms that adherence to Legal requirement (filing of tax returns and publishing of financial statements,) are considered credit worthy by MFIS					
<i>II</i>	Credit Scoring					
	Terms and conditions of loans offered by MFIs results to low loan application by SMEs					
	Short duration of the loans and strict terms of payment offered to SMEs by MFIs affects the rate of loans applied for.					
	Firms Lack of information clarity on nature and terms of credit facilities offered by MFIs results to low application for credit facilities					

D. Credit Policies

7. Indicate the extent to which you agree or disagree with the following statements concerning credit policies of MFIs and accessibility of credit by your firm?

Please Tick the appropriate box

		Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent
		1	2	3	4	5
I	Past Credit Lending history					
	Firms with high rate of defaults in previous loans rarely obtain more loans from MFIs					
	Firms which delay repayments of loans will face harsh conditions when seeking credit facilities from MFIs					
II	Cost of Lending					
	The high interest rates on loans offered by MFIs makes SMEs shy away from seeking credit facilities					
	Complicated application procedures for loans from MFIs makes SMEs shy away					
	Loan application costs charged by MFIs results to low application for credit facilities by SMEs					
III	Lack of Training					
	SMEs lack of training on Credit funds management deters them from applying of credit facilities offered by MFIs					
	Firms lack of training on cost of loans results to low application of credit facilities from MFIs					
IV	Collateral					
	Properties with ownership documents are highly acceptable than those without by MFIs					
	Properties with high value than amount of loans applied for are highly acceptable by MFIs on issuance of credit facilities					
	The ease of capability to sell the assets offered as collateral is considered vital by MFIs on issuance of credit facilities					
	Properties with ownership documents are highly acceptable than those without by MFIs					

8. Indicate the extent to which you agree or disagree with the following statements concerning credit accessibility by your firm from MFIs?

Please Tick the appropriate box

		Not at all	To a low Extent	To some extent	To a greater extent	To a very great extent
		1	2	3	4	5
	Access of Credit From MFIs					
	SMEs obtain loans immediately when they applied from MFIs					
	SMEs were issued with loans every time they applied fro from MFIs					

THE END
THANK YOU VERY MUCH FOR YOUR CO-OPERATION

Small and Medium Scale Entrepreneurs Questionnaire

No.....

Dear Sir/Madam

I am a Master of Business Administration Student at Egerton University conducting a research research entitled *Evaluation of Factors Affecting Access of Credit by Small and Medium Enterprises (SMEs) In Microfinance Institutions: A survey of Nakuru Municipality, Kenya.*

The purpose of this letter is to kindly assist in providing the required information, by filling the questionnaire provided, as your views are considered important to this research. The information obtained is strictly for academic purposes and shall be treated with utmost confidentiality.

Thank you.

Wanjau Charity Wairimu

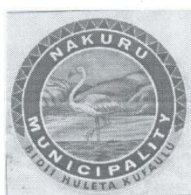
(Researcher)

APPENDIX II: LETTER OF AUTHORITY TO COLLECT DATA

ALL COMMUNICATIONS TO BE ADDRESSED TO THE TOWN CLERK

THE MUNICIPAL COUNCIL OF NAKURU

Tel. No. 051 – 2216380/1
Fax No. 051 – 2210007



Municipal Office
P.O. Box 124
NAKURU
KENYA

Your Ref:

Our Ref: S/10/A/1/2013/LE/be

16th January, 2013

TO WHOM IT MAY CONCERN

RE; RESEARCH AUTHORIZATION – CHARITY W. WANJAU CM11/0623/10

This is to inform you that the above named is a student of Egerton University undertaking Masters of Business Administration Programme. She has been authorized to carry out Research on;

- **Factors affecting access of credit by small and medium Enterprises in Microfinance institutions, a survey of Nakuru Municipality, Kenya.**

Please accord her with the necessary assistance to facilitate her Research.



**LAVUSA EVANS
FOR TOWN CLERK**

When Replying Please Quote Our Reference Number

**APPENDIX III: SUMMARY OF SMES IN NAKURU MUNICIPALITY AS AT
JANUARY 2013**



**LOCAL AUTHORITY INTEGRATED FINANCIAL OPERATIONS MANAGEMENT SYSTEMS
BUSINESS ACTIVITY CODE SUMMARY**

LA Name : - 576 / MUNICIPAL COUNCIL OF NAKURU


Main Activity Code	Main Activity Description :	No of Businesses :	Revenue Potential (Ksh) :
100	GENERAL TRADE, WHOLESALE, RETAIL, STORES,	14,355	61,008,750.00

Business Registration Details

Activity Code :	Main Activity Description :	Category No of Businesses :	Category Permit Fee (Ksh) :	Category Rev Potential (Ksh) :
115	Small Trader, Shop or Retail Service	14,355	4,250	61,008,750
Total No. of Businesses		14,355	Total Potential	61,008,750

There are

- ① 180 Boutiques in the municipality
- ② 90 Salons " " "
- ③ 150 Hardware Shops
- ④ 200 Cosmetics Shops.


 LICENSING OFFICER
 MUNICIPAL COUNCIL OF NAKURU
 P. O. Box 124-20100,
 NAKURU.

16/1/13