INFORMATION ASYMMETRY AND FACTORING IN PROVIDING WORKING CAPITAL TO SMALL AND MEDIUM ENTERPRISES IN KAKAMEGA COUNTY, KENYA

BY

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DECLARATION

I declare that this project is my original work and has not been previously published or submitted to any other College or University for the award of degree or certificate.

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This Proposal has been submitted for examination with my authority as the University's Supervisor.

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DEDICATION

I dedicate this research project to my credit Management teacher Mr. Patrick K. Kairu for the interest he developed in me concerning the area of topic.

ABSTRACT

Kenya like the rest of the world has not remained behind in recognizing the crucial role of Small and Medium Enterprises (SMEs). The significant parts SMEs play is underscored in Kenya's Vision 2030 - the development blueprint which seeks to transform Kenya into an industrialized middle-income country, providing a high-quality life to all its citizens by the year 2030. "Small and medium-sized enterprises account for the largest share of employment in the developing world. They are also more likely than large firms to be credit constrained. These businesses need working capital to operate, to grow and to compete in the marketplace. So access to finance is crucial to their success."(World Bank, *Doing Business 2015).* Despite the critical role played by Small and Medium Enterprises in Kenya, SMEs still face significant working capital constraints. This cash gap must be fulfilled using well thought out tools or method of financing. The purpose of this study was, therefore, to find out if information asymmetry (pre and post) affect adoption of debt factoring as working capital financing for SMEs. The specific objectives were to find out the effect of adverse selection and moral hazard on adoption of debt factoring by SMEs. The target populations were Small and Medium Enterprises in County government of Kakamega. The primary data were collected using structured questionnaire, coded and entered in the Statistical Packages for Social Sciences (SPSS) to aid in analysis.Descriptive statistics tools were used to analyze qualitative data, and inferential tools like regression and standard deviation were used in making conclusions on various aspects affecting the adoption of factoring as a source of working capital financing. Graphs, pie charts, tables were used in presenting the data after analysis. The study found out that there was a strong relationship between information asymmetry and adoption of factoring as a source of working capital financing. That, Information asymmetry has led to distrust by SMEs towards the financing institutions and thus hindered the adoption of factoring. Majority of SMEs owners were willing and ready to work closely with financing institutions and adopt factoring as a source of working capital if correct information is provided and a close working relationship is enhanced.

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CHAPTER ONE: INTRODUCTION

1.1 Background

Mishkin and Eakins (2006) define information asymmetry as a state where one party does not know enough about the other side to make the correct decision. Information asymmetry has also been described as a state where one party to a transaction has more or superior information compared to another (Chege, 2012). The one-sided information creates problems on two fronts: before the operation -Adverse selection and after the transaction -Moral hazard (Mishkin & Eakins, 2006).Adverse selection is the problem that arises as result of one party to deal having more information than the other before the transaction while Moral hazard is the problem created by asymmetric information after the operation (Mishkin & Eakins, 2006).

Factoring is a unique financial innovation. It is a method of converting a nonproductive, inactive asset (i.e., debtors) into a productive asset (viz, cash) by selling receivables to a company that specialises in their collection and administration (Pandey, 2015). Factoring's origins lie in the financing of trade, particularly international trade. Factoring as a fact of business life was underway in England before 1400. It appears to be closely related to early merchant banking activities. The latter however evolved by extension to non-trade related financing such as sovereign debt. Like all financial instruments, factoring developed over centuries (Pandey, 2015).

The study will be anchored in several theories among them: asymmetric information theory, Agency Theory, Working capital management theory, Receivable management, and factoring theory,

1.1.1 Information Asymmetry

Mishkin and Eakins (2006) define information asymmetry as a state where one party does not know enough about the other side to make an accurate decision. He relates the presence of transaction cost to information asymmetry in one party to a transaction has no enough and precise information about the other side. He argues that the individual who has less information will seek the information and that will be provided at a cost. Information asymmetry concept has also neeb define as a state where one party to a transaction has more or superior information compared to another, (Chege, 2012). Mishkin and Eakins (2006) assert that one-sided information will create problems on two fronts: before the operation (Adverse selection) and after the transaction (Moral hazard).

Adverse selection is a problem that arises as result of one party to a transaction having more information than the other before the trade. It happens when the potential borrowers who are the well on the way to create an adverse (unacceptable) result terrible credit are the ones who most efficiently search out an advance and are in this manner destined taken (Mishkin and Eakins 2006, p.26). A problem of adverse selection will occur when potential borrowers who can pose credit risk are the ones whose applications are most likely to be considered. Due to this issue, lenders may decide not to make any loans even though there might be good credit risk in the marketplace (Mishkin & Eakins, 2006)

Moral hazard, on the other hand, is the problem created by asymmetric information after the transaction occurs. Mishkin and Eakins (2006, p.26) describe moral hazard as the risk, the lender face due to due improper or undesirable usage of the fund by the borrower.It is the risk that borrower might engage in activities that are undesirable (immoral) from the lender's point of view. This adverse use of the loan by the borrowers will make repayment less likely. As an example of moral hazard, suppose you lend Ksh 1000 loan to uncle Tom who comes pretending to seek a loan to start a business. Once the credit is given him, he can decide to go for sports lottery with the aim of winning Ksh 20,000. If he wins he will get Ksh 20000, return ksh 1000 and pocket Ksh 190000. If he fails to win, he will lose Ksh 1000 borrowed. The case would have been different had one known what uncle Tom was planning to do. You would have prevented him from playing sports lottery and thus reduce the Moral hazard, i.e., problem after the transaction (Mishkin & Eakins, 2006).

1.1.2 Factoring

Factoring is one of the oldest forms of commercial finance that have been known for centuries. Some scholars trace it historically to Roman Empire (Rutberg, 1994).Its origins lie in the financing of trade, particularly international trade. As a fact of business, the life history was underway in England before 1400. Like all financial instruments, factoring evolved over the centuries. This was driven by changes in the organisation of companies; technology, mainly air travel and non-face to face communications technologies starting with the telegraph, followed by the telephone and then computers. Governments were latecomers to the facilitation of trade financed by factors in most countries (Pandey, 2015).

Factoring has been defined by different countries and authors differently due to non-availability of unified codified law. This has been due to lack of consensus regarding uniform meaning, as well as laid down the scope for such a type of service contract Khan (2007). The study group appointed by the international institute for the unification of private law (UNIDROIT) Rome during 1988 recommended the definition of factoring as an arrangement between the factor and his client which includes at least two of the following: Provision of finance, Maintenance of accounts, Collection of debt and protection against credit risk.Factor chain international, an organisation that regulates factoring worldwide has to define factoring as a complete financial package that combines working capital financing, credit risk protection, accounts receivable, bookkeeping and collection services (Factor Chain international, 2016).This is the definition which has been adopted by many countries including Kenya. Worldwide, four types of factoring are recognised. The four are Full-service non-recourse (old line), full-service recourse factoring, Bulk/agency factoring and non-notification factoring (Pandey, 2005).

Full-service non-recourse is a type of factoring where, a factor purchases the book debts, and the firm assumes 100%credit risk. The full amount has to be paid to the client even if the debt became bad. (Pandey, 2015, EUF Whitepaper on factoring, 2015). Recourse factoring is where factor collects accounts receivables from the debtor on behalf of the vendor. It also maintains credit department to limit credit exposure on behalf the seller. If the customer does not pay the amount of maturity, the factor will recover the amount from the client (James, 2006).

The third type of factoring is bulk/agency factoring. Factor continues to administer credit and operate sales ledger. The financing of book debt is done either on recourse or non-recourse. The factoring commonly used by companies which have a good system of credit administration (Pandey, 2015) and

The last type factoring is non-notification factoring. Here, the factor keeping the record for the sake of a business organisation to which the vendor offers his book obligations (Pandey, 2015).

Globally factoring has played a critical role in bridging the gap of financing working capital among SMEs. Factors chain international report for the year ending December 2012 had affirmed when it showed factoring business volume growing by 6% to reach 2,132,230 euro from 2,015037 euro (FCI, 2012). Across Europe, where factoring is fully developed, the Industry represents 10% of GDP. At the end of 2016, 200 providers of factoring companies were supporting 180,000 business users and providing them with €200Bn of funding (EUF Whitepaper on factoring, 2015).

In Africa, factoring as a source of financing working capital is not well developed except few countries which have successfully used factoring as a source of financing working capital. In Namibia, for example, research which was done by Florette, Gerson, and Patrick, (2008) assert that factoring company provides up to 75 percent of the accounts receivable of SMEs. Other Africans countries which are using factoring as listed in Factoring chain international website includes Egypt, Mauritius, Morocco, South Africa and Tunisia.

In Kenya context, Factoring as a source of financing is not well developed in Kenya. Currently, Biashara factor is the only Non-banking Company offering factoring services in Kenya.The latest report from Factor Chain International (FCI) shows that only two banks; Eco bank Kenya limited and Standard Chartered Bank are the only members of the Factor Chain International in Kenya. In Kenya, the single factoring service being offered by the majority of banks is local purchase order (LPO) financing or invoice discounting. As at today, there are three companies which are doing factoring services in Kenya.

1.1.3 Information Asymmetry and Factoring

According to Muiruri (2014), Information asymmetry is a situation in which one party in a transaction has more or better information compared to the partner. That is, information is held by one, but not all of the parties to a deal.Information asymmetry can lead to two main problems: a) Adverse Selection and b) Moral Hazard.

Mishkin and Eakins (2006, p.26) describe adverse selection to refers to an event in which one party in a transaction has relevant data about the circumstance that the other. For example, a borrower who takes out a loan usually has better and accurate information on where the money usage. Chances of the project succeeding and whether the expected rate return will actualise.

Factoring has been defined as an arrangement between the factor and his client and includes following: Provision of finance, Maintenance of accounts, Collection of debt and protection against credit risk. (Factor Chain international, 2016).

When two (or more) individuals are about to agree on a trade, and one of them happens to have some information that the other(s), this situation is referred to as adverse selection(Akerlof (1970), Spence (1973), and Rothschild and Stiglitz (1976)). Akerlof (1970) considers the example of a seller who has private information about the quality of a used car. A buyer would like to acquire a vehicle but is keen on paying a "fair" price for it, i.e., a rate that is consistent with the quality of the car. The illustration as given by Akerlof (1970) still relevant to date as it asserts the fact that information should not be an asymmetry between the factor and the business owner.

1.1.4 Small and Medium Enterprises

The certainties that Small and Medium Enterprises (SMEs) are the fundamental drivers of the economic growth, employment, investment, innovation, and service delivery globally has not been disputed by any scholars globally.Several researchers have carried research on the importance of SMEs.Studies in both advanced economies and developing countries have indicated that SMEs contribute on average 60 percent of total formal employment in the manufacturing sector.

According to Tucker and Lean, (2003) one of the problems faced by small and medium enterprises firms when attempting to raise finance is information asymmetry. Thus, the information asymmetry problem is partly one relating to difficulties in the spheres of communication and credibility. Memba, (2012), conducted a study to establish the impact of Venture Capital on the growth of SMEs in Kenya. The study argued that lack of finance has been stated as one of the main reasons why SMEs do not perform well in most developing countries. The research established that SMEs made significant growth after accessing the financing and recommended that other SMEs should also follow suit.

Mokogi, (2003), carried out a study to in Kenya to establish whether credit schemes administered by MFIs have an impact on micro and small enterprises (MSEs) performance regarding parameters such as sales, net income, fixed assets, number of employees, and space occupied by the business. Stewart, Richard, & Bill, (2010) also conducted an empirical survey on the impact of SMEs on poor people. The study established that there is some evidence that SMEs enables poor people to be better placed to deal with shocks.

Despite SMEs perspective underscored in vision 2030, they are still facing significant working capital constraints. The scenario witnessed in Kenya particularly in the year 2008 when a fraudulent group of individuals in the name of pyramid scheme came up, and the positive response shown by Kenyans testifies how they desperately need an alternative source of financing.

1.2 Research Problem

Scholars worldwide have agreed that SMEs play critical roles. They have agreed in principle that Small and medium enterprises (SMEs) play a significant role in economic development of every country. Studies both in advanced economies and developing countries have also affirmed this. Ayyagari, Audretsch, Weder & Thurik, (2007) asserts that SMEs contribute on average 60 percent of total formal employment in the manufacturing sector worldwide and this increase to seventy-five percent when SMEs in the informal sector are added.

Stewart, Richard, & Bill, (2010) also conducted an empirical survey on the impact of SMEs on poor people. The study established that there is some evidence that SMEs enables poor people to be better placed to deal with shocks. Woller, (2010) also carried out an empirical study to establish the effects of SMEs in India. The study concluded that SMEs has brought better psychological and social empowerment than economic empowerment. Memba, (2012), surveyed to establish the impact of Venture Capital on the growth of SMEs in Kenya.The study confirmed that SMEs made significant growth after accessing the financing and recommended that other SMEs should also follow suit.

Despite this critical role SMEs play, the problem of SMEs in accessing finance has been with us for years and years. The presence and nature of a “finance gap” for SMEs firms have been debated for decades, ever since. Macmillan report (1931) observed that Small firms have traditionally encountered problems when approaching providers of finance for funds to finance fixed capital investment and working capital for the firm’s operations. Can factoring help?

Factoring is one of the oldest forms of commercial finance that have been known for centuries. Some scholars trace it historically to Roman Empire (Rutberg, 1994). As a fact of business, the life history was underway in England before 1400 (Pandey, 2015).In the developed countries like Europe, Namibia is financing up to 75% of SMEs working capital by use of factoring (Florette, Gerson, and Patrick, 2008). Other countries currently benefited from factoring includes Egypt, Mauritius, Morocco, South Africa and Tunisia. The question is why Kenya has remained behind on adoption of factoring as SMEs financing option?.The aim of this study will, therefore, be, to answer the question does information symmetry affect the adoption factoring as SMEs financing options in Kakamega County?

1.3 Research Objective

- **i.** To determine if Adverse selection affect adoption of factoring working capital financing in Kakamega county, Kenyan
- **ii.** To determine if Moral hazard affect approval of factoring as working capital financing in Kakamega county, Kenyan

1.4 Value of the Study

The study findings will help Management of the financial institution and SMEs by gaining insight into how their companies can efficiently manage the pre and post information asymmetry to their benefit. The research will provide valuable information regarding factoring and thus help in policy development.

Upcoming entrepreneurs and academicians will get relevant information regarding factoring. The research knowledge will contribute to the general body of knowledge and form a basis for further studies.

Lastly, the results of this study will assist policy-makers to implement new sets of policies regarding factoring as working capital management tools for SMEs in Kakamega.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The section presented theoretical literature and examined the various theories upon which the concept of information asymmetry, factoring, and working capital is founded. These arguments were drawn from a variety of disciplines such as finance, law, organisational behaviour among others. The section then reviewed the literature on the type of information asymmetry, types of factoring, need for factoring, areas where it has been used, and lastly summary of the literature review and research gap.

2.2. Information Asymmetry Theory

Information asymmetry is a situation in which one party in transaction situation has more or superior information compared to another (Chege, 2012). Several theories have also been advanced to help affirm the information theory. Adverse Selection and moral hazard are the problems created by asymmetric information before the transaction and after the operation. Adverse selection happened when the potential borrowers who are the most likely to produce an unacceptable (adverse) outcome are the ones who are taking an active role in seeking to be funding and thus most likely to qualify for a loan (Mishkin & Eakins, 2006). Mishkin & Eakins (2006) defined Moral Hazard as the problem created by information after the transaction. Risk (hazard) that the borrower will be involved in ventures that are undesirable(immoral) from the lender's point of view and that this act might make the loan repayment less likely (Mishkin & Eakins, 2006). Random Walk Theories hold that prices of securities depend on factors that affect expected a return and expected risk. Information about these factors are released to the markets at different intervals, and the investors react differently to the news. Security prices, therefore, follow a random walk and cannot, thus, be predicted. The Efficient Market Hypothesis (EMH) contends that data whether right or wrong information once discharged to the market will be immediately processed and reflected in the security prices. If a bad news for example resignation of crucial personnel release, this negative information would automatically lead to a decline in prices of the security. On the other hand, if positive news, example recruitment of crucial staff, news of planned mergers and others, the positive information will automatically lead to security price increase upward. The efficiency of the market is therefore reflected by the speed at which it digests the news.

2.2.1 Working Capital Management Theory

Working capital management theory is a theory which tries to explains two fundamental questions: (1) What is the appropriate amount of working capital, both in total and for each particular account, and (2) How should working capital finance (Brigham & Earnhardt, 2009, p. 643). There are three approaches to working capital, which includes the conservative approach, the aggressive approach and the moderate approach these methods are examined below with their implications. ’

In an aggressive approach, the organisation uses its short-term finances to finance it movable and non-movable assets. The firm that utilises this method of financing will incur less cost but with similar high risk. The approach will enhance profitability as small funds will be tied to the current asset but have chances of cash shortage (John 1955). Under the conservative approach, the other firms only use long-term finance to and small portion short-term funding to finance to its working capital(Eljelly 2004).The method will give rise to a lower risk of financial problems or inventory-' problems but at the expense of reducing profitability (Deloof 2003). Lastly, the

Moderate approach is the mixed between aggressive approach and conservative approach. In this financing, the company uses both the long-term and short-term finance to finance its operation. It is the most common in Kenya today.

2.2.2 Receivables Management and Factoring Theories

These are standards which underline the need and objectives of building up a sound credit policy. It shows how an ideal credit framework can be made, clarify the credit strategy, and control of individual records, propose techniques of monitoring the receivables (Pandey, 2015, p. 601).There two type of credit policy that is Conservative credit policy and Liberal credit policy (Kairu, 2009).He defines conservative credit policy as a policy that is applicable in a monopolistic business environment. The organisation is not overly worried about competition and a liberal credit policy as appropriate in a competitive business environment (Kairu, 2009)

2.2.3 Agency Theory

This is a two-way relationship in which one party known as the principal appoints another individual known as agent and delegate decision-making authority to it. In this connection, the agent acts on behalf of the principal. In finance, there are various types of agency relationships among them: Management versus, shareholders, Shareholders versus creditors.Factoring companies versus SMEs and others. Whenever ownership and responsibility are divorced from control of the principle, conflict of interest arises. Agents may take some action which is an inconsistency with the principal objectives and thus making principle run at lost (Pandey, 2015)

2.3. Empirical Literature Review

Ndungo (2014) carried research on the effects of corporate governance on information The asymmetry between managers and investors in firms listed on the Nairobi securities exchange. The study aimed at investigating how a firm’s corporate governance affects the level of information.The result of the survey shows significance level of more than 97% level confidence. Raheja (2005) and Myerson (1987)assert the same when they found the existence of a significant relationship between corporate governance variables as aforementioned above in firms

Chege (2012) carry out a study on the effect of firm size on information asymmetries surrounding earnings disclosure of companies listed on the Nairobi securities exchange. The investigation demonstrated critical changes in returns and productive spread and high volume shift in the days nearing yearly annual earing announcement by listed firms.Investors should be careful be careful with the way they plan their investment before the earning disclosure and after the earning declaration.The planning will help investors to avoid resulting from information asymmetry.

The presence of data asymmetries among speculators can prompt unfavourable private and social results including low financial investment interest, high exchange costs, thin markets and diminished increases from the exchange (Lev, 1988). Realising the adverse effect of data asymmetry and organisation issues, specialists have recommended a few arrangements, among which corporate administration is an essential component (Jensen and Meckling, 1976; Shleifer and Vishny, 1986).

Odero(2013) researched factors affecting adoption of factoring as a financing option for small and medium enterprises in Nairobi County. Result affirmed that majority of respondents were unaware of the actual benefits of factoring. Respondents were however aware that factoring helps the clients in the collection of receivables and provides finance for the supplier in exchange for his invoices. It was established that factoring is not common in Kenya due to lack of government policies on SMEs, failure by banks to engage most SMEs in factoring, lack of adequate guarantee/ collateral and involvement of entire family in management of most SMEs.

Florette, Gerson, and Postrick, (2008) also carried a research on factoring. They observed that factoring as a source of financing working capital is not well developed in Africa but some countries, in Africa are successfully using factoring as a source of financing working capital. According to the paper above, factoring companies provide working capital funding to up to 75% of account receivables of SMEs in Namibia. Klapper (2000), establishes that average income nations are the best most appealing customer for as they face problem in raising working capital. Sarigul, (2012) also added that factoring is best suited for growing nations because information asymmetries between SMEs and providers of funds commonly make it difficult for businesses to obtain financing. Borgia, Swalehee, and Weeks (2010) also came to the same conclusion that lack of well-developed regulation, poor implementation of the laws, and lack of openness in informational provision make Small and Medium Enterprises at a disadvantage.Borgia et al. (2010) also noted that developing countries had inadequate administration frameworks including poor insolvency and secured exchange laws, which constrain the utilisation of tangible asset as security. Given that debt claims are autonomous of an association's business risk, Borgia et al. (2010)

conclude that factoring had an incentive for companies in such countries to sell accounts and get funds before the maturity date

Richard and Neale conducted a review on factoring and found that Factors do not give new finance, but quicken the money transformation cycle to the customer, enabling them to access the fund more quickly than if they sat tight for standard credit period to reach (Richard and Neale, 2003).

A survey conducted by the European Union considering in 2015 demonstrate that debt factoring has been utilised to finance a range factoring services among them: Working Capital (Finance), Credit Assessment of clients, Sales Ledger Management and Collection, Credit Cover. Globally and more so in Europe, where it is well developed, the Industry accounts for 10% of GDP and 3,5 % of worldwide GDP (FCI, 2015).Toward the end of 2016, roughly 200-factor companies were supporting 180,000 business, providing them with €uro 200 Billion of subsidised finance. Of these customers, about 90% were Small and Medium-sized Enterprises (EUF.2015).

Nilsson (2010) led an examination to examine the Impact of microfinance establishments (MFIs) in the promotion of growth of SMEs in Cameroon. The review embraced a contextual investigation approach that included CAMCCUL-(Cameroon Cooperative Credit Union League).The study concludes that SMEs play a vital role in the growth of developing nations.

Small Industries Development Bank of India (2008) completed a survey that adopted a census approach. The study critically examined the entire National SMEs sector in India on the impact of small, medium enterprises programs. It established that SMEs had assisted many small businesses to prosper.

Amelie (2009) conducted an empirical study on the impact of Small Medium Enterprises on development in African and Asian countries. The study used data of MFIs operating in selected nations and chose average savings and loan balances per client as proxies for growth which indicated that there is empirical evidence for the significant positive impact of Small, medium enterprises on development. The study further established that microcredit is the most robust mechanism to enhance growth in recent years.

Stewart et al. (2010) also conducted an empirical survey on the impact of SMEs on poor people. This study used evidence from Sub-Saharan Africa by adopting user involvement methodology. The study involved four groups of users: those who make policy decisions related to Small, medium enterprises services in Sub-Saharan Africa (SSA); those who provide SMEs services in SSA; those who research SMEs services in SSA and those who use microfinance services in SSA. They concluded that the evidence on micro-savings is small. Braun and Woller (2010) likewise completed an observational examination to find out the impacts of SMEs in India. It was concluded from the review that SMEs brought preferable mental and social strengthening over monetary strengthening.

According to Berger and Udell (2004), the extremely opaque SMEs, which may not have access to loans from financial institutions, can often get financing via factoring. They also noted that, availing accounts receivable factoring services could be a magnetic expansion chance to growing nations, their financial institutions or other businesses.

Borgia et al. 2010 brought up in their examination that there are two critical determinants of the rate of factoring activities in an economy: initially, the accessibility of financial data about ventures; and second, the general level of monetary action.Bushman and Smith (2003) exhibit a system for understanding the connections between the accessibility of accurate information on money related data and firms level effectiveness and decision on financing.

Klapper, (2009 also claim that bank advances account for the significant percentage of SME financing in growing economies. He pointed out that SMEs in such economy find it difficult to access finance since they expect money lenders to have the capacity to record a legitimate claim against all business resources of the firm.According to him, this will require technical innovation and accurate credit information on companies which was lacking. Klapper (2006) likewise recognises that factoring has an exceptional legitimacy in giving financing to higher risk and poorly managed businesses, particularly in growing economies, since factor can base their buy (loaning) choice fundamentally on the reliability of the organisation paying the receivable as opposed to on the customer or borrower. However, factoring may still be hindered by weak contract enforcement institutions and other tax, legal, and regulatory impediments. For instance, factoring requires good historical credit information on all buyers; if unavailable, the factor takes on a significant credit risk.

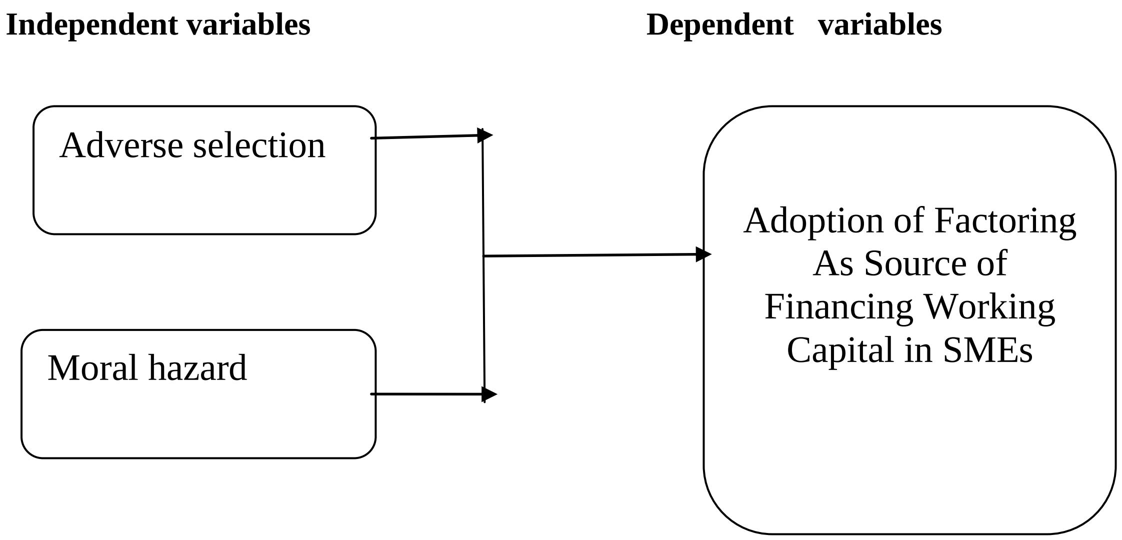
2.4. Literature Review and Research Gaps Summary

Few if any of the of the scholars have objected that SMEs are having a financial problem.The difficulties of SMEs accessing finances has been with us for some years now. Macmillan report (1931) observed that Small firms have traditionally encountered problems when approaching providers of funding for funds to finance fixed capital investment and working capital for the firm's operations. Various research has been done to affirm this. Olu, (2009) also conducted a study to investigate the impact of SMEs on the development of small-scale enterprises that are craving for growth and development in a stiffened economy of Nigeria, Stewart, Richard, & Bill, (2010) also conducted an empirical survey on the impact of SMEs on poor people.

Woller, (2010) also carried out an empirical study to establish the effects of SMEs in India. Memba, (2012), surveyed to determine the impact of Venture Capital on the growth of SMEs in Kenya. In all above mention research, researchers affirmed Ayyagari, Audretsch, Weder & Thurik, (2007) assertion that SMEs contribute on average 60 percent of total formal employment in the manufacturing sector worldwide and this increase to seventy-five percent when SMEs in the informal sector are added.

Few researchers if any have tried to establish if information asymmetry affects adoption of factoring as working capital financing by SMEs in Kakamega. The lack of linking information asymmetry and factoring as a research topic has created a research gap. The study will, therefore, seek to establish if information asymmetry and factoring affect adoption of factoring in Kakamega, Kenya

Figure 2. 1: Conceptual Framework



The independent variables are the factors which influence the adoption of factoring as financing option of small and medium enterprises (SMEs) (dependent variable). This study will seek to determine how all these two factors I. Adverse selection and Moral hazard factors interplay among themselves and how they affect the SME the choice of adopting factoring as working capital finance in Kakamega County, in Kenya.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

The section focused on the procedures that guided the whole process of research design, target population, sample size, sources of data, data collection method, data analysis, data presentation and finally endeavour to depict the validity of research method used to collect the data.

3.2 Research Design

The research design is undertaken to be able to describe the characteristics of the variables of interest in a situation, (Sekaran& Bougie, 2011). This study adopted a descriptive research design because the study sought to answer why SMEs are reluctant to factor their invoices.The design will also help answer the question whether information asymmetry affects factoring. Descriptive research design would be beneficial for this study since it allows the use of various forms of data as well as incorporating human experience The descriptive study design was employed using a sample survey questionnaire. Odero(2013) also used the design successfully and thus the choice of the method.

3.3 Target Population and sample design

Mugenda and Mugenda, (2003) define a population as an entire group of individuals, events or objects having common characteristics that conform to a given specification. According to Saunders (2003), the population is the full set of cases from which a sample is taken. The population of the research was 200 SMEs as registered by the registrar by the department of permits and licences, county government of Kakamega.

A sample is used when the population is too large, (Orodho, 2004).

A sample of 10-30% is good enough if well-chosen (Mugenda and Mugenda 2003).The sample population of the research was 133 SMEs in Kakamega County as registered by the registrar of business and permits. The size was determined using the formulae: Population size =200 SMEs, e = 5% N=200

Therefore n = N/1+N ($e^{2)}$

n = 200/1 +200 (0.05)2 = 133 SMEs

To ensure representativeness of all parts of the population into the sampling, increase efficiency and reduce the error of estimation, the sample population was first dividing different strata based on business types.The strata in this study were the various business types (hospitality and catering industry, Manufacturing, professional firms and businesses, transport industries) in the SMEs. From each stratum (business) a sample of prespecified size was drawn independently in different strata using simple random sampling.

3.4 Data Collection

The questionnaire was used as a sole means of data collection from respondents. The instrument was in the English Language; Five points Likert scale format was used. The apparatus was divided into three sections; the first section had respondent's letter of request to fill in the questionnaire, followed by the section on study variables. Questionnaires were considered most appropriate for this type of survey since they uphold confidentiality and also they can collect data from large samples, (Cooper and Schindler, 2006). Reliability involves precision and accuracy of the measurement procedure (Mugenda and Mugenda, 2003).In this study, reliability ensured by administering the questionnaire to a few identical subjects for the study, and then the results from this sample were compared with the real results, Kothari (2004) define validity as the extent to which a test measures exactly what the researcher wants to measure. Validity was ensured by subjecting the research instruments to a panel of experts on the topic of research before administering them to the respondent.

3.5. Data Analysis and Presentation

Data analysis refers to the process of data editing, coding and tabulation to reveal descriptive and inferential statistics. Inferential statistics were used to make inferences from a sample population parameters while descriptive statistics were used to summarise the data. In this study, the qualitative data were coded and analysed using descriptive statistics. Regression analysis was used to determine the strength of association between adverse selection, Moral Hazards and Adoption of Factoring as a source of working capital financing ($Y = \beta 0 + \beta 1X1 + \beta 2X2 + \varepsilon$). The statistical package for social studies (SPSS) was used to aid in coding, entry, and analysis of data. The data analysed was presented in the form of tabulation, frequencies, graphs and pie charts.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION OF FINDINGS

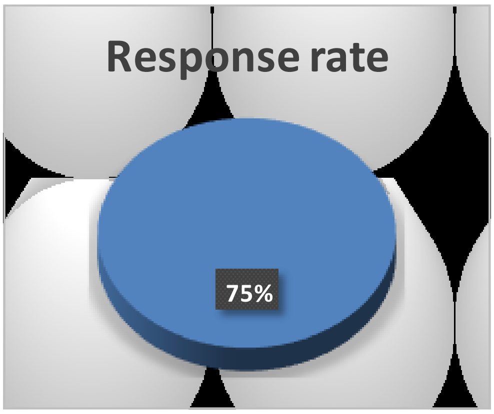
4.1 Introduction

This section covers the data analysis, findings, and discussion of findings. The data was collected and analysed to address the research objectives which were to determine if adverse selection and Moral hazard affect adoption of factoring as a working capital financing option for small and medium enterprises in Kakamega, Kenya.

4.2 Respondents

The study targeted owners of small and medium businesses operating within Kakamega county. The owners were targeted because they are the one who makes a final decision on how to finance the company and where to source the funds. A total of 133 questionnaires were delivered by the research assistant, out of which 100 were successfully filled up and returned. The returned questionnaires from the respondent account to 75% which is more than 50%. According to Mugenda and Mugenda (2003), a response rate of more than 80% is sufficient for research.

Figure 4.1. Response Rate



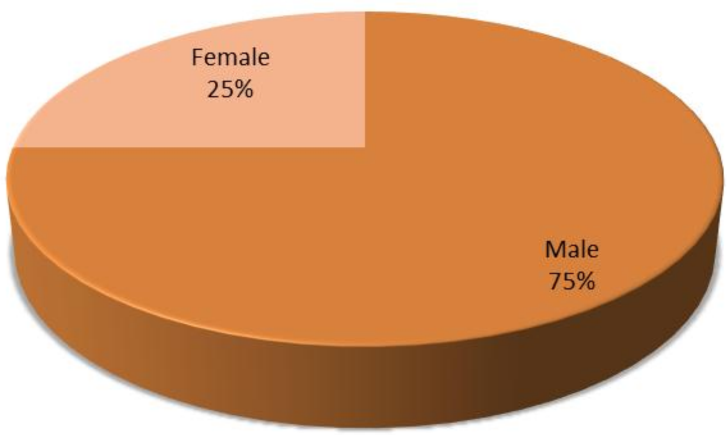
4.3 Demographic Characteristics of Respondents

The researcher sought to know the age of the respondents, gender, the highest level of education and the number of years the business had been in operation. This information would help the researcher to have general information of the respondents.

4.3.1 Gender of the Respondent (%)

Out of the 100 respondents in this study, 75 of the respondent were men while 25 of them were women. The analysis, therefore, shows that more men (seventy-five) (75%) participated in the study than women (twenty-five) (25%) as illustrated in figure 4.2

Figure 4.2. Gender of the respondents.

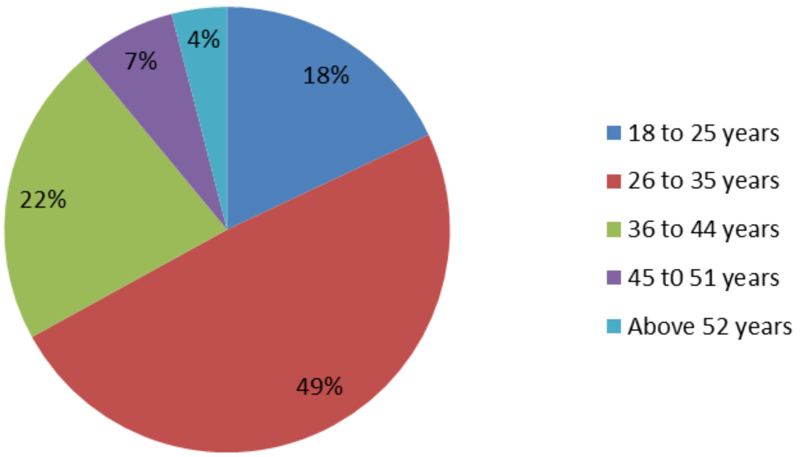


4.3.2 Age of the Respondents

Majority of the responded were between the ages of 26 to 35 giving a percentage of 49%. 22% were between the ages brackets of 36 to 44years, 18% between the ages of

18 to 25 years, 7% between the period of 45 to 51 years and 4 % of the respondents were 52 years and above.

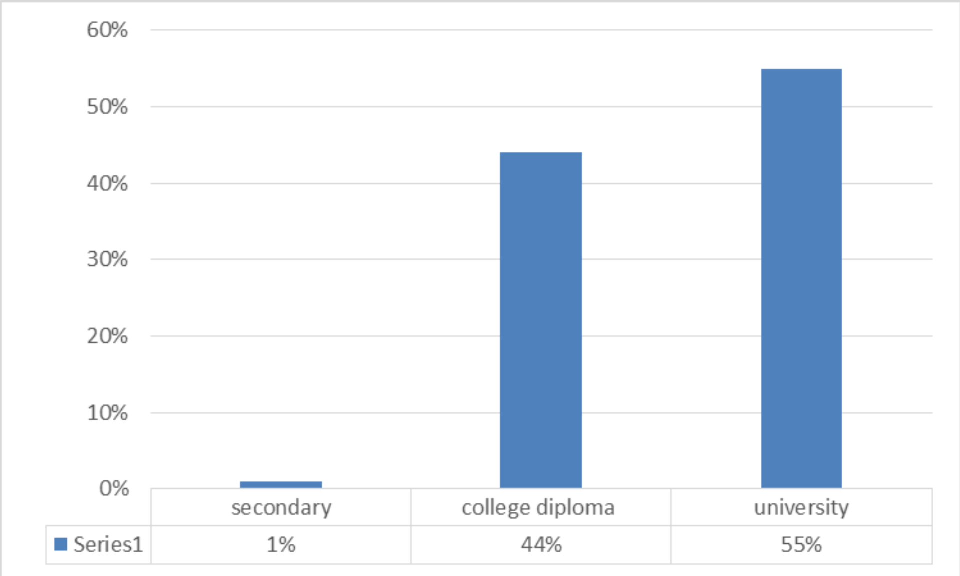
Figure 4.3 Age of the Respondents



4.3.3 Highest Level of Education

Among the respondents, 55% reported to have a university degree as the highest level, 44% were at the level of college diploma while only 1% of the respondent went up to the high school level.

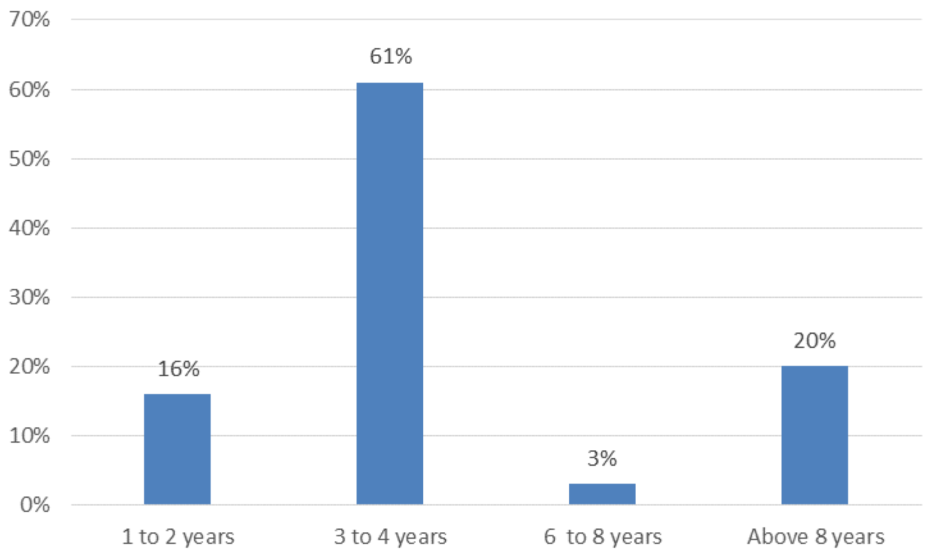
Figure 4.4: Education Level



4.3.4 Period of Business

Majority of the company (77%) were at the age of between the ages of 1yrs to 4yrs.Specifically, 61% reported that their businesses had been existed for between 3 to 4 years, 20% for 8yrs and above, 16% said they had operated for 1 to 2 years while 3% reported having been in existence for 6 to 8 years.

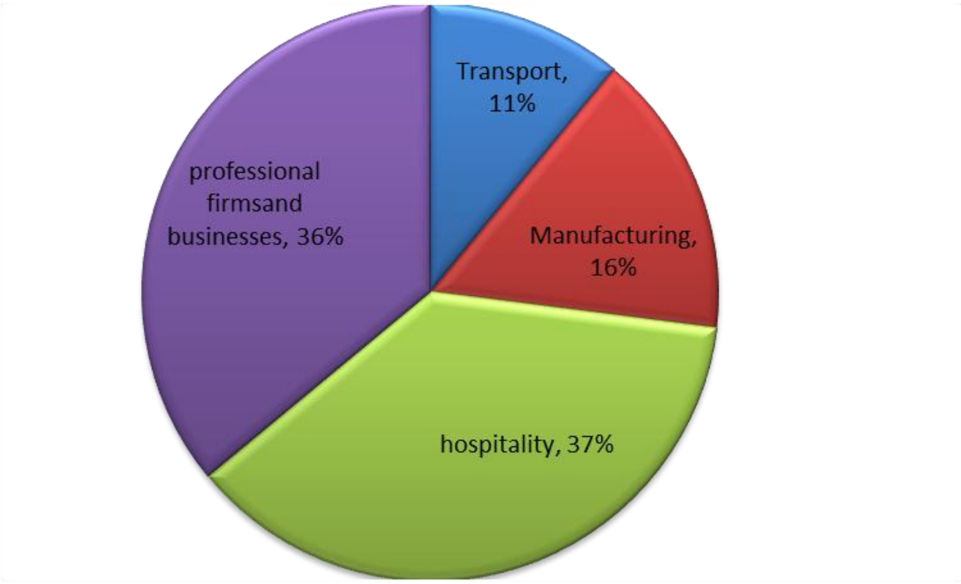
Figure 4.5: Period of Business



4.3.5 Type of Businesses

To enable analysis, the business ware divided into four primary classification that is hospitality firms, professional firms and other business, manufacturing firms and transport industries. Out of these, 37 % were hospitality, 36% were under professional firms and businesses, 16% under manufacturing while 11% under transport industries as illustrated in the figure 4.25 below

Figure 4.6: Type of Businesses

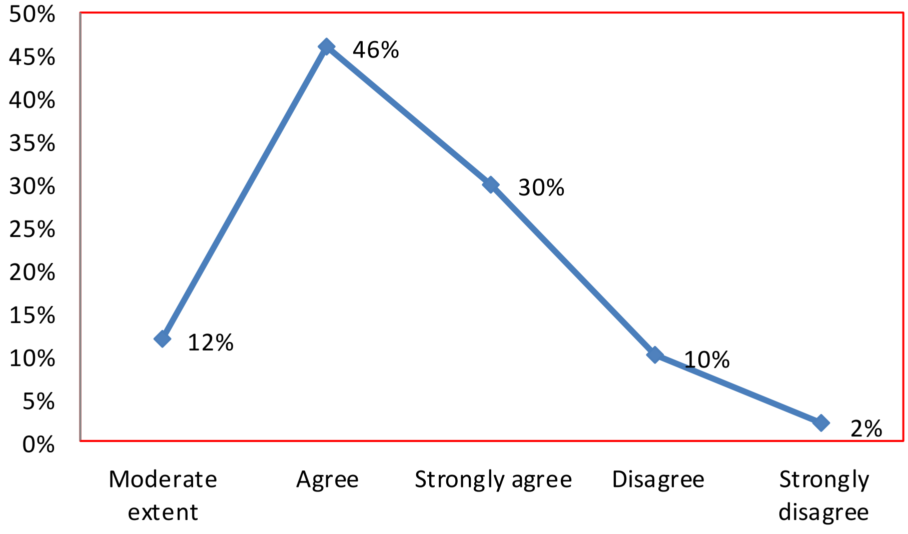


4.4 Information asymmetry(adverse selection)

4.4.1. Adverse selection on adoption of factoring by SMEs

When SMEs owners were asked to which extent do they agree with the statement that some financial institution that offers to finance the SMEs sometimes failed to provide adequate information on the funding to the borrowers. 46% of the respondents admitted that banks indeed were not providing all the information to their client when they are approached for the financing. 30% strongly agreed to the same, 12% moderate extent, 10% disagreed while only 2% strongly disagreed. In general, majority of the respondents (88%) agreed that financial institution in most cases hide some information to the borrowers, i.e., SMEs as illustrated in the figure 4.3.1 below

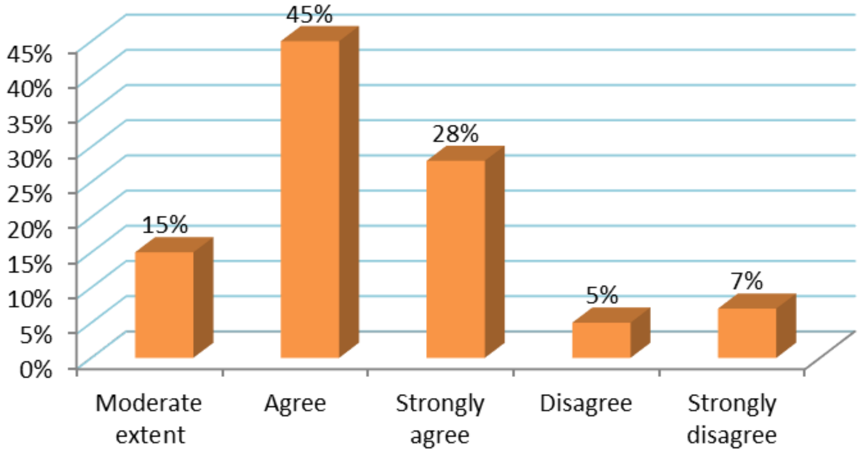
Figure 4.7. Adverse selection (in adequate information)



4.4.2. Adverse selection (Hidden cost) by Financial Institution

When SMEs were asked to which extent do they agree with the statement (Some financial institution often have hidden charges they do not give to SMEs.). Respondent totalling 45% agreed that financial institution most cases have some hidden fees that they do not provide to SMEs.28% strongly agree on the same, 15% on Moderate extent while 7% and 5% strongly disagree and disagreed respectively. As was in the hidden information, it was found out that 88% also agree in general that financial institution usually has hidden cost as illustrated in figure

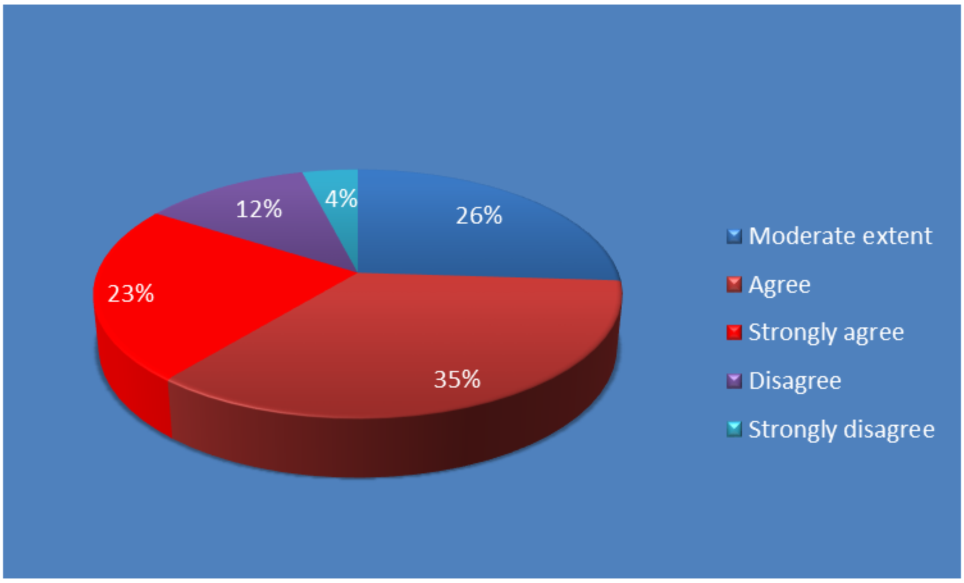
Figure 4.8: Adverse selection (Hidden cost) by Financial Institution



4.4.3 Influence of Adverse Selection on Adoption Factoring

To find out if an adverse selection has a role in SMEs failure to adopt factoring as a financing option, SMEs were asked to comment on the statement (Borrowers (SMEs) are likely to make adverse (unfavourable) selection due to information asymmetry). Out of the 100 respondents, 35% agreed that borrowers (SMEs) are likely to make adverse selection due to information asymmetry. 23% strongly agreed to the same, 26% moderate extent while 12% and 4 % disagree and strongly disagree.

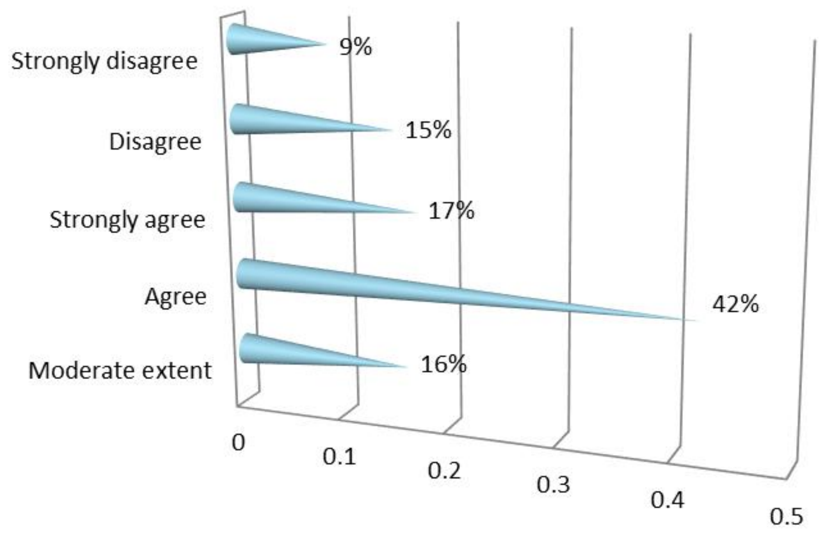
Figure 4.9: Influence of Adverse Selection on Adoption Factoring



4.4.4 Effect of Adverse Selection on Adoption Factoring

When the respondents were asked if they believed that adverse selection is main fear of SMEs not adopting factoring as a financing option, 42% of the respondents agreed that adverse selection is the primary fear of SMEs not taking debt factoring as a working capital financing option. 17% strongly agreed, 16% moderately agreed on the same while 15% and 9% of the respondents disagreed and strongly disagreed respectively. In general, 77% of the respondent agreed that adverse selection is the leading cause of reductants by SMEs to adopt factoring while 23% did not believe that adverse selection is the primary fear of SMEs not taking factoring as a financing option as illustrated in figure 4.10 below.

Figure 4.10: Effect of Adverse Selection on Adoption Factoring



4.5 Information asymmetry(Moral hazard) on adoption of factoring

4.5.1 Increase of Charges after Transaction

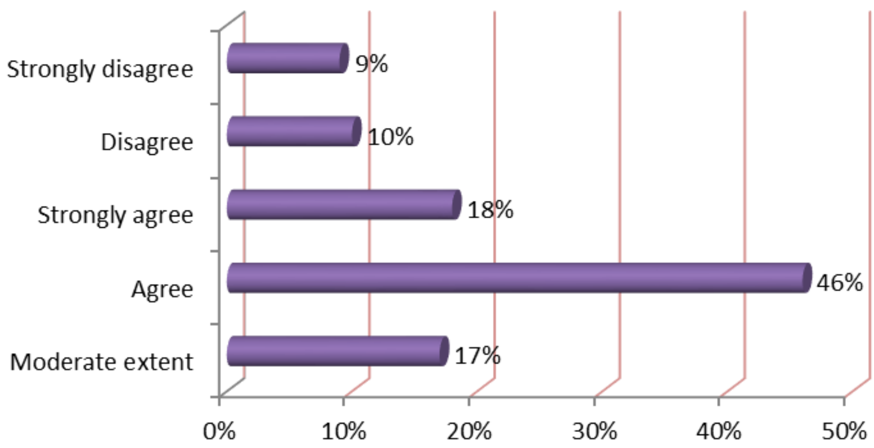
Among the respondents, 46% and18% Agreed and strongly agreed respectively that there is the tendency of lenders to increase costs after the trade.17% of respondent moderate agreed to a moderate extent while 10% and 9% disagree and strongly disagree respectively.

Figure 4.11: Tendencies of Increase Cost after the transaction.

4.5.2 Effect of increase of costs to SMEs after trade

In the argument that the tendency of the financial institution to increase cost affects the SMEs after the deal, 46% of the respondents agreed to this statement followed by 18% who strongly agreed. 17% moderately agreed while 10% and 9% disagreed and strongly disagreed respectively as illustrated in the table below.

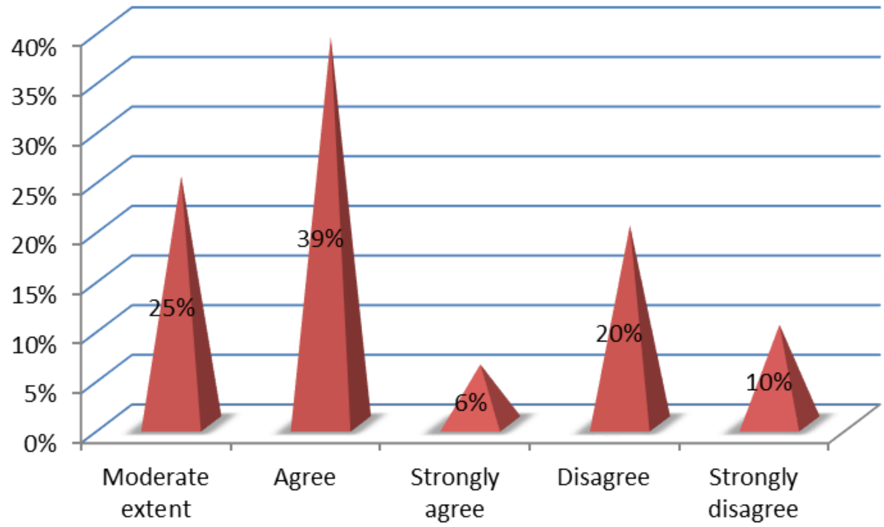
Figure 4.12: Costs Affects transaction to SMEs



4.5.3 Failure to stick to agreement after the deal

39% of the respondents agreed with the statement of the researcher that most financial institutions do not adhere to a contract after the transaction and that SMEs are affected by this omission. 6% strongly agreed with the same while 25% agreed in moderate extent. 20%, however, disagreed while 10% strongly disagreed as indicated in figure 4.4

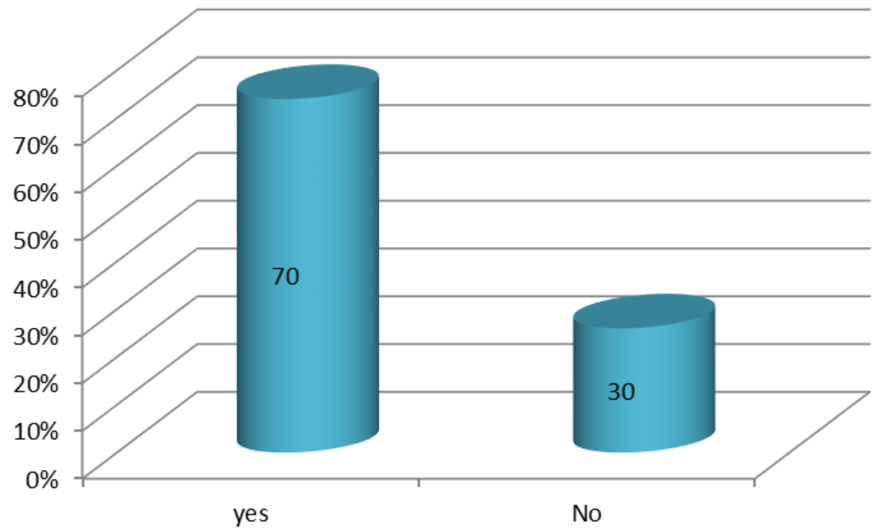
Figure 4.13: Failure to stick to   agreement after the deal



4.6. Information Asymmetry as Primary cause of Non-adoption

According to the findings, 70% of the respondents, in general, believed that information asymmetry is the primary cause of SMEs not adopting debt factoring as working capital financing. 30% did not think or did not agree to this as stated in figure 4.14 below

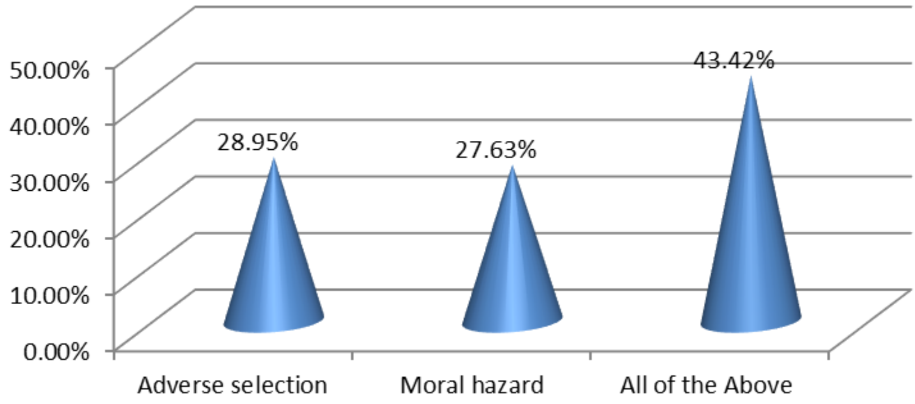
Figure 4.14: Information Asymmetry as Primary cause of Non-adoption



4.6.1 Adverse Selection Versus Moral Hazard Roles

Respondents who believed that information asymmetry affects adoption of factoring were further asked to state between adverse selection and moral hazard they feel affect approval of factoring most. Majority of the respondents 43.42% reported that both adverse selection and Moral Hazard play a significant role in influencing none adoption of factoring as working capital financing option by SMEs. However, 28.95% believed adverse selection play more role while 27.63% felt that Moral hazard plays a significant role as illustrated in figure 4.15 below

Figure 4.15: Adverse Selection Versus Moral Hazard



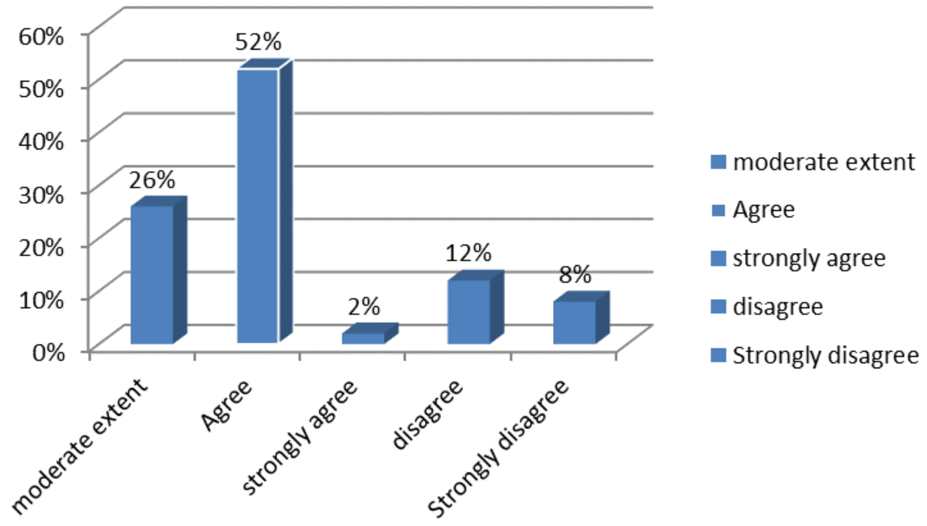
4.7 Need for adoption of factoring as working capital financing

The researcher was interested to know if Small and medium enterprises in Kakamega county would embrace factoring as a source of financing working capital for SMEs. Respondents were asked to agree or not agree with some statement which was pointed out in the questionnaire.

4.7.1 Bridging of working capital Gap

Out of the 100 respondents, 52% agreed that factoring is the best solution to bridge the working capital gap facing SMEs. 2% strongly agreed to the same while 26% agree to a moderate extent.12% moreover, 8% of respondent, however, were of the different opinion and therefore disagreed and strongly disagreed respectively.

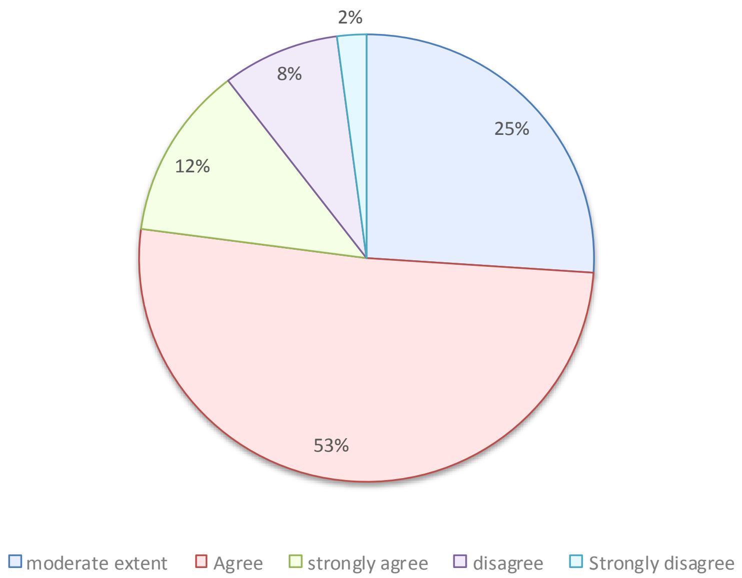
Figure 4.16: Bridging of working capital Gap



4.7.2 Role of Factoring in Credit Management

According to the research, 53% of the respondents agreed that factoring could assist in the credit management. 25% moderately extent, 12% agreed while 8% and 2% disagree and strongly disagreed respectively.

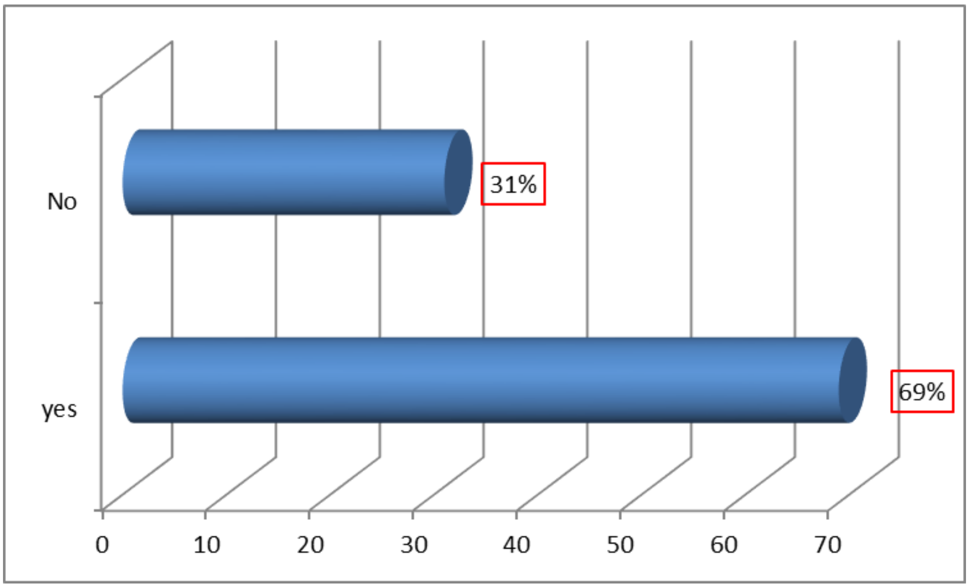
- **Figure 4.17: Role of Factoring in Credit Management**



4.8 Adoption of Factoring by SMEs

Respondents were asked if they are ready to work with the financial institution to adopt factoring as a working capital financing option. 69% of the respondent said they are prepared to work with a financial institution in making the idea reality while 31% of the respondent were not ready as in the figure 4.6.4 below.

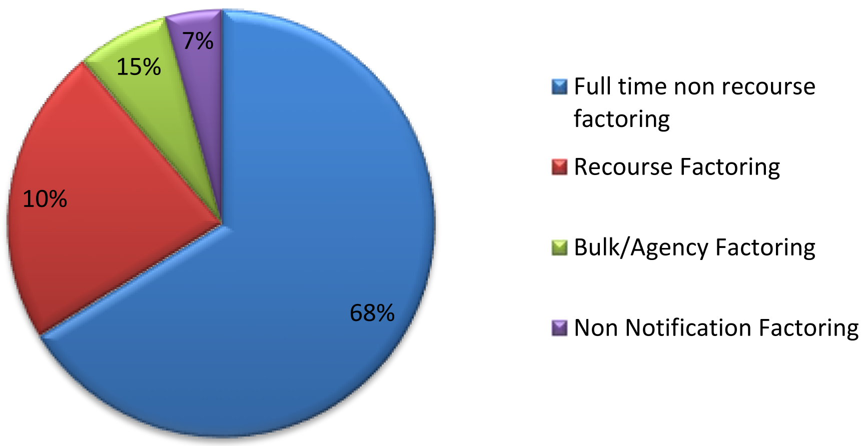
Figure 4.18: Adoption of Factoring by SMEs



4.8.1 Preferred Type of Factoring

Among the respondents who were ready, 68% preferred full-time non-recourse factoring, 10% preferred recourse factoring, 15% chose on bulk/agency factoring while 7% preferred non-notification factoring as illustrated in figure 4.20.

Figure 4.19: Preferred Type of Factoring



4.8.2 Regression analysis

A regression analysis was used to establish the relationship between the dependent and the independent variables; $Y = \beta 0 + \beta 1X1 + \beta 2X2 + \varepsilon$

Where: Y is the adoption of factoring as working capital financing option; X1 is moral hazard; X2 Adverse selection E is Error Term; B0 is Constant Term and B1, B2 are Beta Co-efficient.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	4.035	.494		8.164	.000
	Moral hazard	.007	.084	.008	.083	.934
	Adverse selection	-.199	.098	-.202	-2.033	.045

a. Dependent Variable: Adoption of factoring

The regression equation was;

Y = 4.035 + 0.008 X1 + 0.202 X2 + 0.494

The regression equation above has established that taking all factors into account (moral hazard and adverse selection) constant at zero adoption of factoring is significant. The findings presented also showed that there was a significant negative relationship between adverse selection and adoption of factoring as working capital shown by a coefficient of 0.202(p-value=0.045). Reduction of adverse selection would lead to a 0.202 decrease in non-adoption of factoring as source working capital finance for SMEs.A positive relationship between moral hazard and the adoption of factoring was also observed, but the link was not strong as it had a coefficient of 0.008 (p-0.934), which was more than 0.05(level of significance).

From the result, two independent variables that were studied explain only 2.1% of the factors affecting Adoption of factoring as working capital financing as represented by R2. This, therefore, means that there are many other factors (97.9 %) not studied which affect the adoption of factoring as a source of working financing.

The p-value was 0.032 which is less than 0.05 (level of significance) thus the model was statistically significant in predicting how moral hazard and adverse selection affect adoption of factoring as a source of working capital finance for SMEs.The F critical at 5% level of significance was 2.82. Since F calculated (2.070) was greater than the F critical, this shows that the overall model was significant.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.202[a]	.041	.021	.975

a. Predictors: (Constant), Adverse selection, Moral hazard

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	4.035	.494		8.164	.000
	Moral hazard	.007	.084	.008	.083	.934
	Adverse selection	-.199	.098	-.202	-2.033	.045

a. Dependent Variable: Adoption of factoring

4.9 Discussion

The study aimed at establishing if information asymmetry affects the adoption of factoring by SMEs as working capital financing in Kakamega County, Kenya.The researcher interest was to determine if adverse selection and moral hazard jeopardise the approval of factoring by SMEs in Kakamega. The researcher also wanted to examine if SMEs are ready to work with financial institutions to adopt factoring and factoring preferred.

According to this study findings, the majority of the respondents (70%) agreed that failure to provide proper information on charges by the financial institution before the transaction (Adverse selection) was one of the critical factors that have hindered the adoption of factoring as working capital financing option by SMEs.The finding is in agreement with Sarigul, (2012) who also assert that factoring is appealing to growing nations since information asymmetries between firms and lenders in most cases make it difficult for companies to obtain financing. It also in agreement with Bushman and Smith (2003) who presented a framework for understanding the links between the availability of reliable financial information, enterprise-level efficiency and firms' choice of financing mechanism where factoring was an option.

More than 80% of the respondents agreed that there was the tendency of lenders to increase cost after the transaction(Moral hazard).The same respondent agreed that this unreliability of financial institution had been a critical factor in non-adoption of factoring as working capital financing. However, 19% thought that there was no correlation between moral hazard and adoption of factoring working capital financing. The culture of financial institutions not adhering to the agreement was found to discourage SMEs from approaching financial institutions and thus limiting the adoption of factoring as a source of working capital finance. When asked whether they believed that moral hazard affects the adoption of factoring. 75% of the participants felt that moral hazard is the primary cause of SMEs not adopting factoring. The finding is agreement with Sarapaivanich and Kotey (2006:221) andOlawale, (2011) who point out that the lack of enough information leads to information asymmetry and can cause credit rationing. Therefore, it is hypothesised that there is a positive relationship between business information and access to debt finance by SMEs from commercial banks.

On SMEs willingness to adopt factoring, the majority of the respondents (69%) were very ready and willing to do factoring.On the factoring prefered, the majority of them indicated full-time non-recourse factoring and the reason for this was that the financial institution would not revert to the SMEs in case they fail to collect the amount from the customer (Pandey, 2015). More than 80% of the participants believed that factoring was vital for SMEs to bridge the working capital gap. The study also established that factoring is critical in making a credit decision and the highest percentage of the research participants agreed to the opinion that indeed factoring is essential in assisting SMEs in deciding on credit for working capital financing. The finding is in agreement with Klapper (2006).He acknowledges that factoring has an outstanding merit in helping Small and medium enterprise, explicitly growing countries.He reasoned that factors could fund the majority of SMEs on the ability of the firm paying rather than borrower himself or herself. Berger and Udell (2004), also acknowledges this when they admitted that the extremely dark SMEs, which might go for credits from financial organisations, can regularly get financing from factoring companies.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of findings of the study, conclusion and recommendations drawn from the study objective which is to establish if Information Asymmetry affects adoption of Factoring as Working Capital finance to SMEs in Kakamega County, Kenya. It also will discuss the study objective as answered by the research findings.

5.2 Summary of the Findings

The research explored on the information asymmetry and factoring in providing capital finance to the SMEs in Kakamega County. The researcher investigated how adverse selection affect adoption of factoring as working capital financing option and if adverse selection and moral hazard affect approval of factoring working capital by small and medium enterprises in Kakamega, Kenya. The study used descriptive statistics in describing the data and inferential statistics in making conclusions. Regression was used to predict the relationship between adoption of factoring as a dependent variable and moral hazard and adverse selection as independent variables.

According to the study majority of the respondents agreed that information asymmetry (adverse selection and moral hazard) hinder the adoption of factoring as working capital financing option in SMEs. However, there were a small number of respondents who did not recognise information asymmetry as an affecting adoption of factoring by SMEs. Even though the majority of the respondent (69%) agreed that information asymmetry affects adoption of factoring, it was noted from the regression analysis however that, apart from information asymmetry, there are other factors not studied by the researcher accounting to 97% that influences the adoption of factoring as working capital financing.

It was also established that majority of SMEs were willing to embrace factoring as a source of working capital financing for SMEs.This was because the majority of respondents felt that it will help them in credit management.The researcher established that majority of the study participants were very ready and willing to accept factoring if the issue of information asymmetry is solved.Full-time non-recourse factoring was preferred to the rest of methods because the majority wanted to factor the debt and forget about it and thus the choice of the technique as it will ensure that financial institution does not come back to SMEs in case of failure to collect the debt.

5.3 Conclusion

The study concludes that there is a high association between information asymmetry and the adoption of factoring as a source of working capital financing.The inability of financial institutions to provide proper information contributes immensely in discouraging SMEs to adopt factoring as they fear that they will not get a fair deal. The researcher inferred that adverse selection and moral hazard was the primary cause of SMEs not taking factoring as working capital financing since lack of proper information hinders their ability to make an appropriate judgement. The study discovered that providing essential information to SMEs will improve their relationship with the financial institution and thus increase chances of adoption of factoring as a source of working capital financing in Kakamega County, Kenya.

5.4 Recommendations

SMEs should formulate policies/mechanisms aimed at strengthening their relationship with the financial institution and more so on information access.This will create trust and enable SMEs to make a sound financial decision which will, in turn, promote the adoption of factoring as a source of working capital financing and eventually induce growth of SMEs in the county.

5.5 Suggestions for Further Research

For the researchers, the regression analysis revealed that the studied variables account for only 2.1% which therefore means that, approximately 98% of the factors that hinders adoption of factoring remain unstudied. The area, thus, provides a fertile ground for further exploration as to why factoring is not being done in Kakamega County. More studies should, therefore, be done to dig deeper into the issue and bring forth relevant recommendations that will improve the adoption of factoring as a source of working capital financing not only in Kakamega County but Kenya at large.

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APPENDICES

Appendix I: Data Request Letter

CPA NABOTH OCHIENG ODERO

P.O BOX 36- 50100

KAKAMEGA.

9TH NOVEMBER, 2017

TO

HEAD OF BUSINESS PERMIT AND LICENCE

KAKAMEGA COUNTY

P.O BOX 36-50100

KAKAMEGA

Dear Sir/Madam,

RE: SMALL AND MEDIUM ENTERPRISES LIST

I am a postgraduate student at University of Nairobi pursuing a degree course leading to Master of business administration(MBA).One of my academic outputs before graduating is a project and for this, I have chosen the research topic " **Information Asymmetry and Factoring in Providing Working Capital to Small and Medium Enterprises in Kakamega County, Kenya**.''

As part of the university requirement, am supposed to reveal the source of the population sample. The purpose of the letter is, therefore, to request your office assist me with a list of all the SMEs as registered by your department. The information you provide will be used strictly for academic purposes and will be treated with utmost confidence. Your assistance will be highly appreciated.

Yours Sincerely,

Naboth Ochieng Odero

Appendix ii: List of Small and Medium Enterprises

The REPUBLIC OF KENYA

COUNTY GOVERNMENT OF KAKAMEGA

OFFICE OF THE GOVERNOR

INTERNAL AUDIT SERVICES UNIT

Telephone: 056 -31850/1852/31853 Head of Internal Audit

Email: audit@kakamega.go. Ke P.O. BOX 36-50100

Website: www.kakamega.go.ke **KAKAMEGA**

When Replying, please quote 10th OCTOBER

Business Name
JETIMAS ENTERPRISE RELOADED
BENGWELA TRADERS
OFFICEMAX LIMITED
WEST INDUSTRIES ENTERPRISES LTD
SAVEMOD 9EARTH LINK
SIMUCO HOLDINGS & CREDIT INVESTMENT CO LTD
MUMIAS WEST HOTEL
GOLF HOTEL
JEMBITU BOLT CENTRE
UNIQUE DESIGNERS
MUMIAS SUGAR
COLMAN FASHION WEAR.

CARNATION BOUTIQUE
UNIPAT AUTO SPARES
JOSEPH MACHARIA AND J. WANJIKU
NICEPH COMPUTERS
PERFECT AUTO SPARES
BENSON A ANDATI
BAVARIA VENTURES
JABERIA CONSTRUCTION & SUPPLIES
KIMILILI TIMBER AND HARDWARE
SAFARICOM LIMITED
PRESTIGE SEND-OFF LTD
NEW WAKULIMA LTD
THE GRAND ANNEX BAR AND RESTAURANT
MAMA ZAWADI SHOP /
Mlaleo Retail Retail
C & K BEAUTY SALOON
RUTH NJUGUNA
KWELI ENTERPRISES
FELIX A MBELESIA
DRESS UP DRESS SHOP
DIVINE MERCY COLLECTION
BIAWMAHE
GRAND HOTEL BAR AND RESTAURANT
ROYAL EVE SALON
GOVAN MITUMBA COLLECTION
KAKAMEGA DISHES
NGINYA ENTERPRISES
VALLEY VIEW FASHIONS
CHRISANTUS BARAZA WANYONYI
EDIMA ENTERPRISE
TRAVELLERS DAIRY SHOP
SHANKA'S KIOSK

M. M. JUNIOUR
BEST GENERAL SHOP
MAKUMI AGENCIES LTD
SHIRERE POSHOMILL
MONICA NYUMWITHA & ASSOCIATE
JAMES A. OMULLA
GE'LACHRE INVESTMENTS
MIDTOWN KINYOZI
VISION SHOP
RAFODE LTD
IDEAL ELECTRICAL
DIGITEX INTERNATIONAL LTD
VUMA ENTERPRISES LTD
WANYOIKE, FAITH
MILKEN ENTERPRISES LTD
BUKENYA ANNOINTED ENTERPRISE
CM SHIRIETSO AUTO SPARES
SPARKLES PHARMACEUTICALS
BEMA VILLAGE SHOP
JABBRIA MOTORS
LISUVIRA CHEMIST
FLORENCE.P.SHIHUSA
MAKUTANO KINYOZI
SIR-COOL BAR
MECKO CYCLE MART
PATRICK NYONGESA & ASSOCIATE
MAADO HAIR SALON
STEVE MOTORCYCLE SPARES
BONFACE AMULE OTIPO
CORNER MOTEL
IMANI SHOP
HONGERA SHOP

CLADA PROFESSIONAL COMPUTER
DARAMA SHOP
MALTU
ELSHADAI TAILORING BOUTIQUE
NATIONAL CEREALS PRODUCE BOARD
CLUTCH LOUNGE & GRILL
KIVISHI, DAVID
UGENYA TAILORING AND LAUNDRY
TONNYS & PARTNERS
TONNYS CHEMIST
DASH GUEST HOUSE
AMPEL LIMITED
NDUNE JUNIOR COLLECTION
EMIRATES GENERAL MERCHANTS
DORCAS MUSOTSI
WABS HAIR SALON
AL-JOHARA RETAIL SHOP
HOM-AGE INVESTMENTS
GREEN LIGHT PLANET LTD
MARBLE HAIR SALON
OASIS COLLECTION
BLISS GVS HEALTHCARE LTD
TULSTERS AUTO CENTRE LTD
JOCA INVESTMENT
BBOXX CAPITAL KENYA
WESTLINKS COMPUTER SOLUTIONS
K.MAX ENTERPRISES
SELECT MANAGEMENT SERVICES
LAMONE TECHNOLOGIES
EXTREME DESIGNS
VUMILIA POSHOMILL
GIZMO ENTERTAINMENT

WILSON ATULA
BIDII CAFÉ
DARPTECH COMPUTER SOLUTIONS
MULEMBE DISPENSING CHEMIST
GLADYS MORAA MOMANYI
FELIO CHICKEN PRODUCTS
R.J .SALON
ISANDA JOHN AYUA
EVANS MBANDU TRANSPOTERS
STEPHEN OKOTH
DOLLS CLOSET AND BOUTIQUE
TUMAINI SHOP
MAMA DANIELA SHOP
LYNTON TECHNOLOGIES
BUKENYA ANNONTED ENTERPRISES
BAO SHOP
CADEODEB ENTERPRISE LTD
ALICE YONGE
FOOD WORLD
CYLDA MOTORS SERVICES
MARDAZI INVESTMENT
FAR WEST ENTERPRISES LTD
PULP COLLEGE OF ACCOUNTANCY
SONAR IMAGING CENTRE
CLASSIC TRAVELLERS
MOVIES JOINT.
OKWARO, EDWARD
NETCO NEW KAKAMEGA TOTAL SERVICE STATION
SHANGILIA TAILORING SHOP
LINDAH ACHIENG
AMEDO CENTRE KENYA LTD
NYARANGI, PRISCILA

KET'S BOUTIQUE
CHESIMEI KISIANGANI REUBEN
VESTA HARDWARE AND GLASSMART
LYDIA EGEHIZA ASILIGWA
LINET ANDAYI
KITALE INN HOTEL
NETCO NEW KAKAMEGA SERVICE STATION
INGO PHONE ACCESSORIES
EDWARD MURITHI ODONGO
KAIRALI ENTERPRISES
MARABA POSHO MILL
DAJOHN ENTERPRISES LTD
The Passover Shopping Centre
Nitram Holdings Kimini Shop
BACK SREET KINYOZI
URBAN X COLLECTION
GEOFFREY JUMA AMWAYI
WYCLIFEE AMBANI
MAMA IANS BEAUTY SALON
BEATRICE SHITOTE
IMA TEXTILE CENTRE
SAIWAN GENERAL AGENCIES
MANUS CHEMISTS(M-PESA)
ACCELER GLOBAL LOGISTICS
KAKAMEGA FURNITURE
JAPO ENTERPRISES
EMIRATES FOOTBALL STADIUM
PATRICK MUSUNGU ACHESA
MELISHA CHARCOAL AND FIREWOOD STORE
CABRANDO ENTERPRISES
MARY LAANAH TUMBU
MARY'S SALON

WATERMAN GENERAL AGENCIES
ECOTACT LIMITED
BISON SAT
SEMBELOYA HOTEL
ON THE STREET ENTERTAINMENT
KENYA INSTITUTE OF PROFESSONAL COUNSELLING
MWALIMU NATIONAL SAVINGS AND CREDIT COOPERATIVE SOCIETY
CHANGA MULTI-PURPOSE LTD
WORF TECHNOLOGY CO.LTD
ELGON FASHION
BIN KUTH'S KEROSINA
BROTHERS SHOP
Luchebereri, John
SENDME DOOR TO DOOR DELIVERY COURIER
FRELTON VENTURES
ANYURA AND SONS ENTERPRISE
STANDARD MEDIA GROUP
WEBSITE COMPUTER CENTRE SERVICES
SICHIRAI GENERAL STORE
MAMA ALBERT POSHOMILL
J'S MOVIEMAXX
BIJEY AGENCIES
LITCO INVESTMENT CO. LTD
Samson Gathaiga
ED COMMUNICATIONS
NILDEEP LIMITED
JOHN LIBONDO
MASTERMIND TOBACCO KENYA LTD

Appendix iii: Letter of Introduction

UNIVERSITY OF NAIROBI

SCHOOL OF BUSINESS

KISUMU CAMPUS

Telegrams: "Varsity" Nairobi
Fax: 4181650
Kisumu, Kenya
Telex: 22095Varsity
Mobile: 0720348080
Email: nixono@uonbi.ac.ke

P.O Box 19134-40123
Kisumu, Kenya

Date: 14th November 2017 REF: **UON/CHSS/SOB – KSM/ D61/73326/2014**

TO WHOM IT MAY CONCERN

RE: NABOTH OCHIENG ODERO - REGISTRATION NO: D61/73326/2014

The above named student is in the Master of Business Administration degree program. As part of requirements for the course, he is expected to carry out a study on **"Information Asymmetry and Factoring in Providing Working Capital to Small and Medium Enterprises in Kakamega County, Kenya."**

He has identified your organization for that purpose. This is to kindly request your assistance to enable him complete the study. The exercise is strictly for academic purposes and your assistance will be greatly appreciated.

Thanking you in advance.

Sincerely,

14 NOV 2017

DR NIXON OMORO
ASSISTANT COORDINATOR, SoB, KISUMU CAMPUS

Cc File Copy

Appendix iv: Research Questionnaire

Introduction

This questionnaire was intended to gather pertinent information that will help provide answers to the research questions in the field of study which is information asymmetry and factoring in providing working capital to small and medium enterprises in Kakamega County, Kenya.

PART A: GENERAL INFORMATION

1. Name…………………………………………………………………..
   (Optional)
2. What is your Gender?
   Male [ ] Female [ ]
3. What is your age bracket?
   Between 18-25 [ ] Between 26- 35 [ ]
   Between 36- 40 [ ] Between 41- 44 [ ]
   Between 45-50 [ ] 50 years and above [ ]
4. What is your highest level of education?
   Secondary level [ ] College diploma [ ]
   University degree [ ]
5. How how long has the business been in operation?
   1- 2 Years [ ] 3-5 Years [ ]
   6-8 Years [ ] Over 8 Years [ ]

   What is your line of business?

   Hospitality [ ] Manufacturing [ ]

   Transport [ ] professional and other business (Specify) [ ]

SECTION C: Effect of information asymmetry on adoption of factoring by SMEs in Kakamega County, Kenya.

1. Kindly indicate the level of agreement on the effect of information asymmetry on adoption of factoring as working capital financing SMEs in the following aspects. Use a scale of 1 to 5 where: 1 = strongly disagree 2 = disagree; 3 = moderate extent; 4 = agree; 5 = strongly agree.

Adverse selection	**1**	**2**	**3**	**4**	**5**
Financial institution who offer finance usually fail to provide proper information on charges					
Financial institution often have hidden charges which they do not give to borrower(SMEs)					
Borrower (SMEs) are likely to make adverse selection due to information asymmetry.					
Adverse selection is the primary hindrance of (SMEs) in adopting of factoring as working financing option.					
Moral hazard					
There is the tendency of lenders to increase charges after the transaction.					
The tendency of the financial institution to increase costs affect the SMEs after the transaction.					
There is a tendency of the financial institution not to adhere to the agreement after the deal strictly.					

2. Do you believe that information asymmetry is the primary Cause of SMEs not adopting debt factoring as working capital financing?

(1) Yes ( ) (2) No ( )

3. If yes, which one between adverse selection and Moral hazard play significant role in non-adoption of factoring by SMEs

(1) Adverse selection ( ) (2) Moral hazard ( )

(3) All of them ( )

4. Need of adoption factoring as working capital finance by small and medium enterprises in Kakamega County, Kenya.

Need of Factoring	**1**	**2**	**3**	**4**	**5**
Factoring is the best solution to bridge the information gap between financial and SMEs.					
Factoring assists in credit management					

2. Are SMEs ready to work with the financial institution in adopting factoring as a financing option for SMEs?

(1) Yes ( ) (2) No ( )

3. If yes, which type do you prefer?

(1) Full-Service Non-Recourse ( )

(2) Recourse Factoring ( )

(3) Bulk/Agency Factoring ( )

(4) Non-Notification Factoring ( )

Appendix v: Time Plan

Activity	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER
Project development				
Approval				
Data collection, analysis, Project write-up.				
Project submission				