

**SHORT TERM IMPACT OF INTEREST RATE CAPPING ON AVAILABILITY OF
FUNDS TO SMALL AND MEDIUM SIZE MANUFACTURING ENTERPRISES IN
NAIROBI**

BY

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DECLARATION

This research project is my original work and has not been presented for the award of a degree in this University or any other institution of higher learning for examination.

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This research proposal has been submitted for examinations with my approval as the university supervisor.

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DEDICATION

This research project is dedicated to my Mother and Sister for their support and encouragement.

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ABBREVIATIONS

CBR	Central Bank Rate
SME	Small and Medium Sized Enterprises
SMIEIS	Small and Medium Industries Equity Investment Scheme
KNBS	Kenya National Bureau of Statistics

ABSTRACT

The purpose of this study was to determine the short-term impact of interest rate capping on availability of funds in Nairobi County. This study was guided by the research question; what is the impact of interest capping on availability of funds to small and medium size manufacturing enterprises in Nairobi, Kenya? A descriptive research design was adopted. The study had a population of 1,072 Manufacturing SMEs in Nairobi County out of which a sample of 107 was selected. The data utilized secondary data; data was collected from the SMEs financial statements. The study data was analysed for descriptive statistics. The findings revealed that the interest rate capping had an impact on the availability of funds to manufacturing SMEs. The Study recommends that interest rate cap should be set and reviewed regularly to ensure it suits all the players in the market i.e. the demand side and supply side. Private and public sectors together with the government should put in place favourable regulatory framework to provide conducive business environment like reducing obstacles in accessing finance from commercial banks, dealing with inflation and interest rates.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Interest rate caps, as usury laws, probably characterize the lengthiest and most gone over intervention in financial markets by government Homer (2005). Numerous nations industrialized as well as unindustrialized world come up with interest rate upper limit on consumer credit Ramsay (2010). They comprise Netherlands, France, Poland, Belgium, Slovakia, Ireland, Canada, several Australian nations as well as several US states, Brazil, Japan and South Africa (Hart, 2009).

In 2000, the government through the Donde Bill unsuccessfully attempted to cap the interest rates on the rate that banks offer loans and deposits (Kegoro, 2003). However, the 11th parliament passed a bill in 2016 that allowed the banking regulator to cap the interest's rates. The Banking (amendment) Act 2015, enacted by the Parliament of Kenya placed a cap on loaning rates at four percent over the Central Bank Rate (CBR) and a floor on the deposit rates at least seventy percent of the CBR. The act also requires the commercial banks or financial institution to disclose all the terms relating to the loan to the borrower.

Commercial banks or financial institution in the Kenyan economy are an intermediary by which Small and Medium Sized Enterprises (SMEs) deposit funds and finance their operations. They make money from the difference between the deposit rate and borrowing rate. These rates are determined by demand and supply that is market forces and other factors that relate to interest rate.

The introduction of a lending and deposit rate ceiling for commercial banks and financial institutions in Kenya has brought an argument regarding the suitability of monitoring involvement to cap the interest rates that are seen by policymakers to be exceptionally lofty and also there was a public uproar that the banking organizations are generating considerable revenues to the disadvantage of borrowers. In this case, the interest rate cap acts as a tool for consumer protection.

The study is anchored by three major theories which are the loanable funds theory which will look at the market interest rates, classical theory of interest rates that will explain at the demand and supply funds and the last one is liquidity preference theory which will give further details about on the demand for money

1.1.1 Interest Rate Capping

Today, everything has a price. In finance, the price means the interest rate, which is the rate at which the borrower pays interest for the utilization of the borrowed funds from a lender or fee paid on assets that are borrowed (Brealey et al, 2001). The original amount is referred to as the principal and the proportion of principal, which is paid over a period, is the interest (Ivey, 2002; Heaton, 2002). The fixed amount payment made by a borrower each calendar month is referred to equated monthly instalment. The commonly used definition of interest is a price at which money is lend and borrowed (Liebner, 2014).

The term interest rate capping can be defined as rules that limit the amount of money a lender may, directly or indirectly charge, for capital use by the borrower. In consumer credit markets, interest rate capping may be referred to as the regulations that limit the price of credit contracts (Liebner, 2014).

Governments use interest rates caps for various political as well as economic motives. The major reason is to protect SMEs in manufacturing industry by making access to credit more affordable and increase access to finance from exploitation by the banks and financial institutions and to enable actions taken against unfair and deceiving lenders. Capping may similarly aid in safeguarding SMEs's and the citizen's interest by making sure that a rational as well as fair interest rate on credits. As such, interest rate caps could similarly be an appropriate means to edge loan access to certain underprivileged as well as low-income consumers, since they assist in circumventing social maltreatment.

Capping is also used by governments to offer a particular division of the economy or industry support. Lastly, consistent with a different underlying principle, as the cost of credit may be subjective and monopolistic and therefore exceed the actual cost of giving credit, establishing a lesser cap on interest would however let lenders carry out operations. In nations where commercial banks and financial establishments bear great market power controlling, the cost of lending can be given a reason for protecting consumers Dewatripont and Tirole (1994).

Economic theory puts forward that imperfections of marketplace will be attributed to information asymmetry and the failure of creditors to distinguish between safe and uncertain borrowers Stiglitz (1981). When making decisions regarding credit commercial banks or financial establishments are not fully able to ascertain a borrower's possibility of settlement of the credit. Two key issues come up: Adverse selection and moral hazard. The traditional lending methodology, which uses social capital as well as risk knowledge in people to value risk, helps to manage adverse selection. However, interest rate restrictions usually originate at the lower end market that financial institutions and banks depend on

the information asymmetry to explain high loaning rates. In a market that is non-competitive, the lender will probably hold the controlling influence to generate too much profits lacking competition levelling them out.

There will be segmentation of financial markets in order for big commercial banks service more clienteles with more loans at lesser interest rates and microfinance institutions effect increased rates of interest on a higher volume of credit with smaller value. Amidst, undersized commercial banks are often able to discover a niche-aiding medium to large businesses.

1.1.2 Availability of Funds

Access to credit refers to the ability of individuals and enterprises to obtain external funding to enable them ease cash flow problems Osoro and Muturi (2013). Credit can be either short term or long term depending on the lenders evaluation of the borrowers' ability to repay. SMEs can obtain finance from commercial banks, financial institutions or alternative sources, which plays a critical role in SME financing

(Monteiro, 2013) observed that SMEs usually have limited access to non- bank lenders due to cost of credit, strict loan conditions and lack of creditworthiness in their information which is frequently unpublished hence they are challenged by finance. The main concern of this study is to see the impact of the interest rate capping and availably of credit to SMEs.

1.1.3 Interest Rate Capping and Availability of Funds

Cost of credit is composed of four components, which are the market interest rate, operational costs, the bank's revenue margin and costs for default risk. When the functioning of the market is regulated by the Government, supply and demand cannot work

together easily to reach the equilibrium price as well as quantity. When an artificial ceiling is present, funds apportionment is one-sided when the equilibrium price is beyond the upper limit. The result is individuals who desire to have funds, but as a result of their situation do not become eligible at the upper limit interest rate therefore not getting access. By this huge market segment not accessing finances in the formal economy, they choose the informal economy. By restricting the interest rate established, the government could possibly compel several actors within this market underground.

The concern of accessibility of finances by SMEs has been long established to be in existence by Bawuah et al. (2014); a different challenging concern assumed to be impinging on small businesses is lofty interest rate. Lofty interest rates result in a decline in the obtainability of internal as well as external funds compared to loan requirement of enterprises. This path is considered most essential for small businesses which are probably limited in their financial accessibility.

The financial institutions have been blamed for charging excessive interest rates and generating economic revenues (Mohane, 2000). They attribute the lofty interest rate to high administration cost of unsettled credits as well as nonpayers who ultimately push up lending cost devoid of resultant increase in credit turnover. Credit defaulters lower financial establishments' resource base for more loaning, as a result, dwindling workforce morale and impinging on the debtor's confidence. The result is that financial establishments ought to establish the risk premium adequately high to recompense for the risk resulting in disparities in the required as well as expected return on credit.

Laeven (2003) ascertained that financial eased up processes, for instance the elimination of interest caps, have positively impinged on obtainability of funds by SMEs, whereas Foster (2006) noted a movement of customers to nations having a lesser amount of restricting loaning. Different results in the US establish that loans access for high-risk borrowers is higher where interest rate caps are greater though that high loan cost raises the default likelihood. Additionally, even though the institution of caps in the credit union market reduced interest rates, the stream of loan reduced.

1.1.4 Small and Medium Size Manufacturing Enterprises (SMEs) in Kenya

The role of SMEs is important for economic growth. Contribution to national income, employment creation, poverty reduction and exports promotion are some examples for their contributions. When referring to enterprises in this study, the focus is mainly on SMEs, both existing and potential, in the manufacturing sector. SMEs are described in different ways between nations and sectors. Meanings contrast in terms of the number of people they hire, as well as in the primary basis adopted for grouping; Therefore, SMEs encompasses extensive meanings and metrics, differing amongst nations as well as sources reporting the SME information (Ayyagari, Beck & Demirguc-Knnt, 2003).

The Micro and Small Enterprise Act (2013) outlines micro and small undertakings. Enterprises are referred to as ‘micro’ when their total workforce is from 1 to 10 with a turnover below Ksh500, 000. They are regarded as ‘small’ when their total workforce is from 11 to 50 with a turnover below KSh5 million. Stevenson et al. (2005) defined SMEs in terms of the “very-small” businesses having staff between 6-10 working “in-the-open” and the “small-scale” businesses having staff between 11-50 working from real enterprise premises.

As stated by the US Small Business Administration (SBA) that is established on section 3 of the Small Business Act of 1953, An SME is going to be considered to be one which is individually held as well as run and that is not leading in its area of business. As the Economy of Kenya is geared up to initiate a point of fairly above average growth, the role of financial establishment to direct credit at reasonable cost and proficiently to SMEs will turn out to be ever more essential for all-encompassing as well as sustained economic growth. SMEs are essential for economic growth, expansion, and job creation, and that they constitute 49% of GDP averagely in countries of high-income and 29% in low-income nations (Beck, 2007). Kenya has a mutual agreement amongst stakeholders in the financial sector that the small enterprises sector is fundamental to a vibrant private sector. Enhancing obtainability of financial services for SMEs is major support of the general financial sector restructuring and growth strategy (Kenya Treasury, 2011). The market for SMEs finance in Kenya is fast developing and every commercial bank appears to be keen on increasing their commitment with SMEs irrespective of ownership or size.

1.2 Research Problem

SMEs are possibly of unlimited socio-economic importance in job creation, revenue generation as well as reduction of poverty as noted by different literatures. Though, their long-term development as well as attractiveness is hindered by the limitations on their obtainability of formal-sector funding, systematic and institutional issues among others in developing nations. Therefore, SMEs' share of finances is not proportional than their comparative significance in national job creation and to the value added.

Deprivation of finance accessibility has been identified as a hindering factor in SMEs growth. This has often led to lack of capacity to acquire needed resources and services to

grow and poor machinery maintenance or replacement (Levitsky & Oyen, 1999). One of the major factors is high interest rates and strict requirements by the financial institutions that they require to have access to the funds. This issue puts manufacturing SMEs in Nairobi in a tight spot whether to rely on their individual savings, retained earnings, friends' aid, government and donor support or financial establishments to fund their undertakings. This study seeks to give an explanation to the research question, what is the impact of interest capping on availability of funds to small and medium size manufacturing enterprises in Nairobi, Kenya?

1.3 Research Objective

This study seeks to measure the short-term effect of interest rate capping on availability of funds on the small and medium size enterprises in Nairobi, Kenya.

1.3 Value of the Study

The study will be of benefit to the current SMEs in understanding the effect the interest rate capping by central bank and therefore be able to plan their activities since they will be in a better position to predict the cost of credit and use it to make informed decisions. Potential local and foreign investors will use the findings of the study to know the right time to enter the Kenyan market given the general direction the government wants to take regarding economy.

The results of this study will be directed at making lenders, borrowers, policy makers and legislators to appreciate the role of central bank in consumer protection. More so, the central bank on its supervisory role will be challenged to make sound policies to ensure stability in credit market to foster growth of the economy.

The study will also bring forth more interest in the investigation of the topic and uncover spheres that require further study and investigation. Future researchers could fill the gap in the uncovered areas hence contributing to the knowledge frontier in this sphere of interest rate effects on SMEs.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This part reviews the fundamental theoretical and empirical concepts regarding interest rates capping and if at all there is a link between interest rate capping and obtainability of funds by SMEs. The chapter addresses the theoretical review guiding the study, empirical literature and research gap identified.

2.2 Theoretical Framework

This study bases its arguments on the loanable funds theory, Keynes liquidity theory of interest rate and classical theory of interest rate.

2.2.1 Loanable Funds Theory of Real Interest Rate

This theory was advanced by Swedish economist Knut Wicksell. Under the loanable Funds theory, interest rate is influenced by demand and supply of loanable finances within the capital market. It puts forward that investment as well as savings within the economy define the amount of longstanding interest rates. Short-term interest rates are defined by financial as well as monetary situations of an economy. Consistent with the loanable funds theory for the economy in entirety given the significance of loanable funds as well as that the key providers of loanable funds are commercial banks.

The major purpose of this financial intermediary in establishing interest rates is well-defined. The central bank is applying particular monetary policy; thus, it impacts on

loanable funds supply from commercial banks. As central bank (increases) or lowers credit supply obtainable from commercial banks, it lowers (increases) the interest rates level.

As stated by Saunders (2010) under this concept interest rate is established similar to the demand and supply of goods is established, loanable funds supply surges with increases in interest, holding other aspects constant. He adds that loanable funds demand is increases as rates of interest decline, holding other factors constant. He similarly established two factors among others resulting in a shift in economic situations as well as monetary increase by the demand curve for loanable funds.

In relation to the loanable funds theory, economic mediators strive for making the maximum utilization of the resources obtainable to them in their lifespan. Among the means of enhancing future real income could possibly be to have a loan of funds at present so as to exploit the economy's investment prospects. This will simply operate if investment's rate of return were higher than the cost of obtaining credit. These credit takers would not be ready to pay increased real interest rate than the rate of return obtainable to capital. Investors are willing to invest as well as loan simply if there is an assurance of real return with regards to their savings that will enable them use up more in future than they would if not be able to do. The degree to which individuals are ready to delay use is determined by their time preferences (Saunders and Cornet, 2011).

2.2.2 Classical Theory of Interest Rates

This theory is similarly termed as the demand and supply theory and was put forward by the economists Marshall and Fisher (1930). Afterward, Pigou, Cassel, Knight and Taussig sought to adapt the concept. The concept determines interest rate by use classical theory of economics. Interest rate is defined as the element that compares savings to investment. The

concept explains interest rate as a point of equilibrium created by an intersection point of supply of savings and borrowing demand curves. Therefore, when savings exceed investments the rate of interest will fall, and when investments exceed savings rate of interest will rise until equilibrium is attained. The increase in interest rate will encourage savings.

Other advocates of the classical theory of interest have a different opinion. According to Marshal (1961), interest rate can be viewed as the price paid for the use of resources. Rate of interest is impinged on by a point of intersection between supply savings curve at fixed income level and demand of capital at varied rates, which will in turn influence the marginal propensity to save. However, this theory fails to take into account other factors besides supply and demand. These other factors such as income and wealth also have a significant impact on interest rate determination.

2.2.3 Liquidity Preference theory

Similarly termed as the Monetary Theory of Interest, this theory was developed by Maynard Keynes (1936) and it was based on economic growth theory. He put forward in this concept that interest rate is impinged on by the money supply as well as the willingness to retain it. He therefore regarded money in the role of a liquid asset, interest being the cost of that liquidity loss.

Keynes termed liquidity preference theory as interest rate determined forward in the broad concept of interest, employment as well as money. The value for money is for both store of wealth and transactional motive. According to Keynes, there are three motives for holding money, namely: transitional, speculative and precautionary. The theory will be

very useful in the research to explain the extent to which interest rate capping will affect the availability and cost of funds to the SMEs in Nairobi, Kenya.

Howells and Bain (2007), inform us than an improved inclination for liquidity in the model is the same as to increase demand for money and hence demand for money increases wherever people think that interest rates are expected to go up than believes that are going down. Thus the study will identify the rationale of liquidity theory on the relationship between interest rate capping and money supply to manufacturing SMEs in Nairobi.

2.3 Factors Affecting of Availability of Funds to SMEs

There exist various challenges that SMEs encounter in their quest to access funding for business development and growth. This section reviews the main challenges that SMEs face which vary from cost of credit, strict loan conditions, poor management practices and financial indiscipline among others.

2.3.1 Cost of Credit

Financial liability that anyone has to incur to access a given financial credit from a financial institution or bank is referred to as cost of credit Gitari (2012). High cost of credit or interest rates remains to be not favourable to SMEs because the cost of credit can possibly weaken earnings, and result in investment loss. The condition is much more distressing when bearing in mind the circumstances in the manufacturing industry. The banks contemplate giving credit to the manufacturing industry as high risk, hence the banks offer credit to manufacturing businesses in disparity rates. Occasionally, the interest rate increases up to 36% or beyond (World Bank Survey, 2001).

According to Aabii (2014) banks have repeatedly been criticized for making super normal profits more than the dilemma of SMEs seeking financing. Banks and financial institutions usually contend that lofty cost of loan is way above their control as the base interest rates is established by CBK, but actuality; the interest rates offered by banks to SMEs remain far greater compared to the central banks' base rate (Charbonneau & Menon, 2013). In Kenya for example in the past five years, the base rate of central bank has remained 8%, yet, banks have remained to charge SMEs equal to 24% to obtain loan facilities being 16 points exceeding the base rate (Wanjohi, 2010). Either way it is looked at, the unfair characteristic of banks concerning SMEs looking for loans drives costs of loan above what is usual, making it unaffordable for several SMEs.

2.3.2 Strict Loan Conditions

Strict loan condition is a key aspect impinging on obtainability as well as access finances to SMEs. According to Gichuki et al., (2014) many SMEs cannot obtain loans from banks and other financial establishment because of the stringent requirements that SMEs must live up to. Therefore, banks and financial establishments restrain from lending to SMEs because most of them do not have collateral. Without sufficient collateral, financial institutions have limited ways to protect the credit assets. Incidentally, the strict requirements are imposed to mitigate and cushion the risks associated with SME lending.

As stated by Wanjohi (2010), as much as SMEs complain challenges in access to funds from financial institutions, financial institutions have to protect themselves against the risks. If a financial institution feels that a given SME bears a high default risk, they are obligated to prevent them funding. It is not simply a prudent intent but similarly one that is intended for protecting banks and financial establishments end result. Gangata and

Matavire (2013) investigated challenges faced by SMEs towards financial credit access determined that a small number of SMEs thrived in obtaining financial credit. Failure to obtain loans was due to SME not meeting stringent financial requirements, major one being high collateral necessities.

Several SMEs don't have proper management policies. Families own many of the SMEs leading to unsound internal control and management policies. Similarly due to unsound management of the SMEs, there exists an apparent lack of an appropriate bookkeeping of financial accounts. There is similarly absence of specialized as well as economic analysis as such enterprises hardly employ the service of competent professionals. Inappropriate business transactions records definitely constrain obtainability institutional loan.

Risk factor is a critical component in loan appraisal that as well as financial establishments employ in evaluating the viability of an enterprise (Berg et al., 2013). Business risk factor describes the reason several SMEs can obtain financing whereas some do not. In most instances, when an SME has a poor business risk rating, financial establishments would hardly offer credit to such enterprises. Also, if an SME has a poor evaluation for both enterprise as well as financial risk, the likelihood for accessing loans through established financial institutions becomes minimal (Zopa, 2011).

2.4 Empirical Studies

Ogujiuba, et al. (2004) examined credit obtainability to Nigerian SMEs. A conceptual as well as statistical comparative cross-sectional data was used to evaluate the SMIEIS program in Nigeria in relation to capital base of banks in determining whether it provides an efficient way of dealing with the funding issue of Nigerian SMEs as well as its related effect on financial strength within the structure. From the analysis, it was ascertained that

there is need for government to at once tackle the issue of financial intermediaries with respect to strength in the system as a national precedence and establish institutions that would initiate the reform course. It was recommended by the study that there is need for banks to play more dynamic part in realizing the goals of SMIEIS by re-capitalizing and establishing different desks to manage the finances as well as dynamically discussing the ideas for instance some other bank product. This will lessen the dilemma of weak asset base as well as high collaterals. However, the long-term growth and competitiveness of SMEs are compromised by the constraints on their access to alternative forms of finance, among other systematic and institutional problems in developing countries. Limited access of SMEs to credit and financial services has been identified as one of the most important supply constraints confronting the manufacturing sector in Kenya

Vuvor and Ackah (2011) similarly carried out a study in Ghana to examine the challenges facing SMEs in accessing funds. According to the responses from the questionnaires disseminated, it was clear that SMEs in Ghana similar to those in various nations face major challenges in obtaining loan. The challenges comprise the lack of capacity by SMEs to give collateral as well as some data required by banks for instance audited financial report in addition to the high credit cost with regards to lofty interest rates thereby hindering the obtainability of bank credits. However SMEs should also reduce the dependence on banks and financial institution and take advantage of institutions set up by the government to assist them in terms of finance and training needs.

Gangata and Matavire (2013) explored the challenges faced by SMEs in obtaining funding from financial establishments. It was determined that a very small number of SMEs make it in obtaining finances from financial establishments, due to failure to meet lending

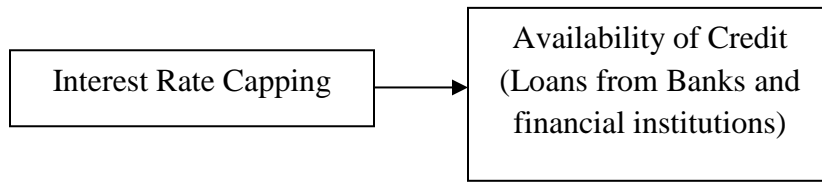
conditions, for instance providing collateral security. Their study shows that SME rely on banks and other financial institutions to get funding. They SMEs should also take advantage of institutions set up by the government to obtain funds for growth and development.

Kimutai and Jagongo (2013) in their study on factors influence rationing of credit by Kenyan commercial banks, a metric of apparent credit risk, the scholars ascertained that the major aspects that impinge on rationing of credit by the in Kenyan commercial banks are loan features, firm features as well as noticeable features. The study recommended that it is helpful for banks to undertake rationing of credit however it ought to be undertaken with expertise plus without biasness. Also the aspects that impinge on credit rationing ought to be assessed carefully by the individuals in control and accorded precedence prior to providing loan.

2.5 Conceptual Framework

The conceptual model below describes the expected link between the study variables. It explains the process that takes place from the onset of financial crisis to how it may affect stock returns.

Figure 2.1: **Conceptual Model**



Independent Variables

Dependent Variable

Source: Author 2018

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This part presents the research methodology. The chapter entails research design, population and sampling design, data collection techniques, research procedures, data analysis methods as well as chapter summary.

3.2 Research Design

Research design is the manner in which data collection as well as analysis will be organised so as to realize the research objectives by way of empirical proof (Cooper & Schindler, 2006). A descriptive type of research design was employed by this study. The aim is to gather material that could be evaluated, patterns taken out and comparison done for purposes of clarification and provision of basis for decision making. Quantitative data will be obtained for evaluation.

3.3 Population of the Study

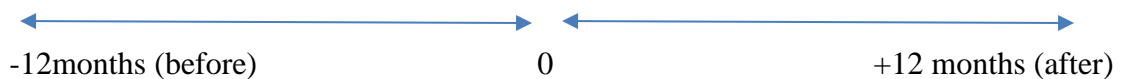
A population is defined as a combination of people, animal and plants from which data can be collected. It is a huge collection of `people, objects or organizations that form the major emphasis of a scientific question. As noted by Coopers and Schindler (2006) a population is also defined as the entire collection of factors regarding which the researcher wants to make conclusions for the research. The target population under this research were the registered SMEs in Nairobi. According to Nairobi county trading licenses, it is estimated that there are approximately 1,072 manufacturing SMEs operating within Nairobi County.

3.4 Sample of the Study

Since the population for this work is large, convenience and random sampling approach will be adopted in respondents sampling. A simple random sampling was carried out in each strata (Mugenda & Mugenda, 2003). It is advised that a minimum of 10% of the population should be sampled. The sample of this study will be 107 small and medium manufacturing enterprises operating in Nairobi industrial area. The sample will be divided into small and medium SMEs as follows; Micro-enterprises have not exceeding 10 personnel; small enterprises have 10-49 personnel whereas medium sized enterprises have from 50 to 99 personnel (KNBS, 2016).

3.5 Data Collection Method

This research used secondary data sources. Data was obtained using data collection form. The data collection form was administered during working hours. The secondary data was collected from financial statements of respective SMEs. The study period was 12 months before and 12 months after interest rate capping. The month interest rate capping took effect will be considered as month 0.



3.6 Data Analysis Methods

The study evaluates the impact of interest rate capping on availability of funds of SMEs through descriptive statistics. Analysed data is presented in the form of graphs, tables, mean and standard deviation. This was used to describe the collected data that is, the loans that the SMEs received from banks and other financial institutions.

The descriptive analysis will measure the variance and standard deviation of the loans received by the SMEs before and after the capping and try to identify if the capping had an impact on the loan uptake. Loan variance analysis using standard deviation was used to understand the relationships between the dependent variable which is the loan and independent variable which is the capping by the SMEs.

3.7 Test of Significance

To assess the statistical significance the F – test as well as T – test were utilized at 95% confidence level. The F statistic was used to evaluate a statistical significance of regression whereas the t statistic was utilized to measure statistical significance of research coefficients.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the findings and discussions of short term impact of interest rate capping on availability of funds to manufacturing SMEs. The data derived from the secondary data sources was analysed and interpreted in line with the objective of the study.

4.2 Response rate

The study targeted the manufacturing SMEs operating within the county of Nairobi. The target sample was 107 SMEs. The data acquired for the purpose of this study was 66 in number making it 61% response rate. Mugenda & Mugenda (2003) pointed out that 70% is very good, 60% is good and 50% is adequate, this means that 61% response rate in this study is good.

Table 4.1: Response rate

Response Rate	Frequency	Percentage
Responsive	66	61%
Unresponsive	42	39%
Total	107	100%

Source: Research findings

4.3 Data Analysis and Findings

In data analysis, descriptive statistics was used specifically testing the significance of the difference in means and standard deviation of loans received from commercial banks before and after the capping of the interest rate.

4.4 Descriptive Statistics

The study sought to find out the characteristics of the data obtained from the manufacturing SMEs on the loans the received form the commercial banks for the two periods under the study i.e. the period before interest rate capping and period after the interest rate capping.

The mean, median, and standard variation of the data was considered.

The result finding for the two periods is shown in the tables below;

Table 4.2: Descriptive Statistics for 12 months period before interest rate capping

<i>Pre Capping</i>	
Mean	1474919.20
Median	928022.50
Mode	436000.00
Standard Deviation	1502172.44
Kurtosis	5.71
Skewness	2.45
Range	7047860.00
Minimum	423240.00
Maximum	7471100.00
Sum	97344667.00
Count	66.00

N = 66

Source: Research findings

The results from table 4.2 shows statistics of loans advanced to manufacturing SMEs by commercial banks for a period of 12 months i.e. August 2015 to July 2016 before interest

rate capping came into effect. The results show the average loans granted by the banks for the period was Ksh. 1.4 million. The maximum amount of loan granted was Kshs. 7.4million while the minimum loan was Kshs. 423,240. The total amount of loan to SMEs during the period was Kshs 97million. The mean of the loans granted before the interest rate capping deviated from the mean by Kshs. 1.5million.

Table 4.3: Descriptive Statistics for 12 months period after interest rate capping

<i>Post Capping</i>	
Mean	1376168.27
Median	939594.50
Mode	306332
Standard Deviation	1384906.05
Kurtosis	5.97
Skewness	2.46
Range	7053353
Minimum	137767
Maximum	7191120
Sum	90827106
Count	66

N = 66

Source: Research findings

The results from table 4.3 shows statistics of loans advanced to manufacturing SMEs by commercial banks for a period of 12 months i.e. October 2016 to September 2017 before interest rate capping came into effect. The results show the average loans granted by the banks for the period was Kshs. 1.3 million which is 0.1million less compared to period

before the capping. The maximum amount of loan granted was Kshs. 7.1million while the minimum loan was Kshs. 137,767. The total amount of loan to SMEs during the period was Kshs 90million. The mean of the loans granted before the interest rate capping deviated from the mean by Kshs. 1.3million.

Table 4.4: Comparative Statistics for the two periods before and after interest rate capping

	<i>Pre Capping</i>	<i>Post Capping</i>
Mean	1474919.20	1376168.27
Median	928022.50	939594.50
Mode	436000.00	306332.00
Standard Deviation	1502172.44	1384906.05
Kurtosis	5.71	5.97
Skewness	2.45	2.46
Range	7047860.00	7053353.00
Minimum	423240.00	137767.00
Maximum	7471100.00	7191120.00
Sum	97344667.00	90827106.00
Count	66.00	66.00

N = 66

Source: Research findings

A comparison of the statistics for the two periods shows the following observation. The mean of loans granted to manufacturing SMEs by the commercial banks decreased from Kshs. 1.4 million to Kshs. 1.3 million. The minimum amount granted after the capping was Kshs. 285,473.00 lower compared to the period before the cap was introduced and the same also reflected on the maximum amount granted which went down by Kshs. 279,980.00.

The standard deviation for the loans granted also changed significantly from Kshs. 1.5 million before the capping to Kshs. 1.3 Million after the interest rate capping.

Table 4.5: F-Test Two-Sample for Variances

	<i>Pre Capping</i>	<i>Post Capping</i>
Mean	1474919.197	1376168.273
Observations	66	66
F	1.176519027	
P(F<=f) one-tail	0.257062613	
F Critical one-tail	1.508382599	

Source: Author computations

using excel

Table 4.6: T-Test: Paired Two

Sample for Means

	<i>Pre Capping</i>	<i>Post Capping</i>
Mean	1474919.197	1376168.273
Observations	66	66
Pearson Correlation	0.988081217	
t Stat	3.187617462	
P(T<=t) one-tail	0.001103192	
t Critical one-tail	1.668635976	
P(T<=t) two-tail	0.002206384	
t Critical two-tail	1.997137908	

Source: Author computations using excel

The p-value is significant if it is less than 0.05 since the confidence level used is 95%. From the table, since p-value is 0.001 which less than 0.05, the impact of the interest rate capping were significant.

4.5 Summary and Interpretation of findings

The study explored the short term impact of interest rate capping on availability of funds to manufacturing SMEs in Nairobi County as suggested by the literature reviewed. From the results displayed in table 4.4 the interest rate capping was significant in influencing the availability of funds to manufacturing SMEs. The study found out that interest rate is an important factor in determining the availability of funds supplied by commercial banks.

We can see that from the results above that an introduction of interest capping in September 2016 has a significant effect in the amount of loans granted by commercial banks in Kenya.

The amount of loans granted after the capping decreased significantly by Kshs. 6.5 million holding other factors constant. This can be partially explained by the fact that commercial banks have been compelled to increase their risk mitigation measures which has led to tightening credit standards especially to the manufacturing firms.

Most of the literature reviewed indicates that interest capping is advantageous to the economy but Black et al. (1997) studied the imposition of interest rate capping when the government puts ceiling on interest rate and concluded that the markets demand and supply do not interconnect freely. They argued when the government puts a ceiling on interest rate, the movement of funds is not changed if the equilibrium price is overhead leading to limited access to credit to the manufacturing SMEs due to their poor management practices, their inability to give collateral and ability to pay

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter explains the summary of the study findings, the conclusions of the study, recommendations for policy purposes and practice purposes as well as pointing out the limitations of the study and the recommendations for further research.

5.2 Summary of Findings

The objective of the study was find out the short term impact of interest rate capping on availability of funds to manufacturing SMEs in Nairobi Count. In order to achieve the objectives of this study, descriptive research design was adopted to facilitate the collection of original data necessary for this study. The target population comprised manufacturing SMEs within Nairobi County.

The study was done comprising 66 manufacturing SMEs in Nairobi County. Monthly data was collected and analysed for a period of 2 years with 12 months before and 12 months after the interest rate capping came to effect. Secondary data was collected from the financial statements of the SMEs, edited and formatted before being analysed. Both descriptive statistics and t-test statistical analysis was done on the data obtained to establish the short term impact of interest rate capping on the availability of funds to manufacturing SMEs.

Descriptive statistical analysis indicated that the mean, minimum and maximum levels of loans granted to the manufacturing SMEs by the commercial banks dropped after the implementation of the interest rate capping showing that the capping had a negative impact to the availability of funds to the manufacturing SMEs. The T-test analysis indicated that P values of <0.001 hence p being <0.05 concluding that the difference is significant and that interest rate capping has an impact on the availability of funds.

5.3 Conclusion

This study has discussed in detail the importance of manufacturing SMEs to the Kenyan economy. The deficiency of funds has made manufacturing SMEs growth and development and issue of concern to many developing countries especially Kenya. These concerns have led to various research being carried out to find out what has and should been done to ensure manufacturing SMEs have access to finance. Various outcomes and contributions have been made ranging from local and international studies have been reviewed in this study to find out what has existed already.

The study ought to study whether the capping of interest rates influenced the availability of funds to SMEs. The findings show that there exists a negative relationship between interest rate capping and availability of funds to manufacturing SMEs. When the interest rate capping came in place, there was a general decline on the loan amount granted by commercial banks.

The introduction of interest rate capping by the Kenyan Government was done in good faith to protect the public and SMEs from high interest rate that was being charged by commercial banks and other financial institutions. The study concludes that the interest capping distorted the law of supply and demand in the market and led to commercial banks and other financial institutions to introduce tough conditions to reduce their exposure to credit default risk hence making it hard for manufacturing SMEs access funds for their operation and growth.

5.4 Recommendation

SMEs in Kenya play a key role in creating employment and improving the economic growth. The main driver for this includes availability of funds that will boost growth and sustainability of the SMEs. Having said that, interest rate cap should be set and reviewed regularly to ensure it suits all the players in the market i.e. the demand side and supply side. Private and public sectors together with the government should put in place favourable regulatory framework to provide conducive business environment like reducing obstacles in accessing finance from commercial banks, dealing with inflation and interest rates.

This study also recommends that manufacturing SMEs should look for alternative sources of funds apart from debt. The main source of financing in the manufacturing sector is the debt. The main reason is because; SMEs especially family businesses that occupy a huge percentage of businesses in Kenya prefer debt as they do not want to give up control to outsiders.

5.5 Limitation of the Study

The main limitation of this study was the period over which it was carried out. Since the study was carried out on only manufacturing SMEs and a year into the new interest rate capping regime, more time may be required to enable studies to be conducted over a number of years in order to find out the long run impact of interest rate capping on availability of funds

Another challenge faced was when collecting data to be used in this research. Most of the SMEs were not willing to cooperate and give the required information as they deem it confidential while others denied access to their premises.

5.6 Suggestions for further Research

This study mainly undertook to find out the impact of interest rate capping in availability of funds to manufacturing SMEs in Nairobi County. The study can be extended to investigate the impact of interest rate capping to other sectors of the economy not only the manufacturing sector.

Since the interest rate capping has brought about strict conditions to obtain loan from financial institutions so as to reduce the credit default risk, further research maybe undertaken to investigate the level of corruption by the bank officials that goes on in the financial institution. This is also a major obstacle that SMEs face when trying to obtain loans from these institutions.

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APPENDICES

APPENDIX II: Data Collection Form

Company Name	Total loan accessed (Shs)	Company Name	Total loan accessed (Shs)
August, 2015		September, 2016	
September, 2015		October, 2016	
October, 2015		November, 2016	
November, 2015		December, 2016	
December, 2015		January, 2017	
January, 2016		February, 2017	

February, 2016		March, 2017	
March, 2016		April, 2017	
April, 2016		May, 2017	
May, 2016		June, 2017	
June, 2016		July, 2017	
July, 2016		August, 2017	
Total			

APPENDIX 1: List of Small and Medium Enterprises

1. BRASS & ALLIED INTERNATIONAL LIMITED
2. ADORN AFRICA COMPANY LIMITED
3. AFROCHEM PRODUCTS
4. AHABSY LIMITED
5. ALIKI PRINTERS & STATIONERS LTD
6. ALLIANCE STEEL WORKS LTD
7. ARCHITECTURAL SUPPLIES LTD
8. AROM CHEMICAL INDUSTRIES
9. ASTRAL TECHNOLOGIES LTD
10. AUTOMATIC CONTROLS LTD
11. BESTWAY PRINTING PRODUCTION LTD

12. BETHEL BLISS ENTERPRISESS
13. BINYOS SERVICES
14. BIRIKS INVESTMENT LIMITED
15. BLOWPLAST LTD
16. BONTECH VENTURES
17. BOSKY INDUSTRIES LTD
18. CANTON STEEL FABRICATORS LTD
19. CHEMIGAS LTD
20. CONTROL AIR LIMITED
21. CREATIVE MANUFACTURERS LTD
22. DHAMU ENGINEERS LTD
23. DIASTAR AUTO CARE CENTRE LTD
24. DORMAN LTD
25. EAST AFRICAN METAL WORKS LTD
26. ECONOMIC HOUSING GROUP
27. ELECTROWATTS LTD
28. ELITE TOOLS LTD
29. EQUATORIAL COATINGS LIMITED
30. ESLON PLASTICS OF KENYA LTD
31. EXOTIC WOOD PRODUCTS LTD
32. FARM ELECTRICAL AND AIR CONDITIONING ENGINEERS LTD
33. FINE WOOD WORKS LTD
34. FORNACIS MECHANICALS
35. GENERAL PRINTERS LTD
36. GERALD AUTO GARAGE
37. GILOIL COMPANY LTD
38. GLAMOND COMPANY LTD
39. GOLTAB MELAMINE (K) LTD
40. GRAND PAINTS LTD
41. GURDEV ENGINEERING & CONSTRUCTION WORKS LTD
42. HER AND MAN CLOTHING

43. HUSSEINI GLASSWARE MART LTD
44. INTECH ENTERPRISES LTD
45. KAMBA MANUFACTURING (1986) LTD
46. KARACHIWALLA (NRB) LTD
47. KARSAM SERVIETTES CO. LTD
48. KATESON LIMITED
49. LITTLE AFRICA (K) LTD
50. LOCHNESS LIMITED
51. MARCANDY SOLUTIONS LIMITED
52. MICHFLORA SUPPLIES LIMITED
53. MYNER LOGISTICS LIMITED
54. PARAMOUNT LOGISTICS
55. SAHEM ENTERPRISES LIMITED
56. SAVERINE HOLDINGS
57. SERABED COMPANY LIMITED
58. SMART EAST AFRICA ENTERPRISES
59. SUMWIGA ENTERPRISES LIMITED
60. SUNSHINE SIGNS AND DESIGNS
61. THERMODYNAMIC ENERGY ENGINEERS LIMITED
62. TRIME ENGINEERING COMPANY
63. TUMAINI MECHANICAL ENGINEERING LIMITED
64. TURIDY'S FASHIONS
65. UJENZI LANDMARK LIMITED
66. ZAWADI MANUFACTURERS LIMITED