THE EFFECT OF ISLAMIC BANKING PRODUCTS ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NAIROBI COUNTY

BY

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DECLARATION

This research project proposal is my original work and to the best of my knowledge has not been presented in any institution or university for academic purpose(s).

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I dedicate this research project to my family as well as friends for their devotion, encouragement, tolerance, inspiration and understanding. They provided me the motivation as well as the strength of mind to accomplish this research project.
ACKNOWLEDGEMENT

It would not have been imaginable to undertake this research project devoid of the support of my supervisors Dr. Kennedy Okiro and Mr Ronald Chogii. I am sincerely appreciative to them for their commitment, helpful guidance, scholarly support as well as devotion of their time all through this undertaking. I thank God for his blessings and good health. It could similarly not have been possible to complete this journey without the love and encouragement of my family as well as friends and I express my gratitude and deep appreciation to them for their tireless support.
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<tr>
<td>AMA</td>
<td>Advanced Measurement Approach</td>
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<tr>
<td>BIA</td>
<td>Basic Indicator Approach</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>NBC</td>
<td>National Bank of Commerce</td>
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<td>NMB</td>
<td>National Microfinance Bank</td>
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<td>Small and Medium Enterprises</td>
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<td>ROA</td>
<td>Return on Assets</td>
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ABSTRACT
Small and Medium Enterprises (SMEs) essential in various nations, predominantly in emerging economies. This investigation adds to the growing number of literatures and figures out the situation in Kenya by examining the effect of Islamic banking products on the performance of SMEs. This study examined the relationship between Islamic banking products and financial performance of SMEs in Nairobi County between 2013 and 2017. The main goal of the investigation is to verify the influence of Islamic banking products on performance of SMEs in Nairobi County. Data on Islamic financial products and financial performance were obtained from 39 companies using a secondary data. By way of the Ordinary Least Squares (OLS) regression, the outcomes pointed out that there is a positive link between Islamic banking products and financial performance. Regression model was performed in the analysis of data to estimate the quantitative effect of Islamic banking products on the financial performance of SMEs in Nairobi County. The investigation established a Pearson correlation value R of 0.651 which depicts that there is a linear dependence of Islamic banking products on return on assets (ROA). R square revealed that Islamic banking products attributes influenced about 42.4% of variation in return on asset. The value of adjusted R square was established to be of 33.1% which clearly brought out that the link between Islamic banking products and ROA of SMEs. Generally, the study ascertained that there significant link between Islamic banking products and financial performance of SMEs in Nairobi County. Overall, the results indicate a statistically significant effect of Islamic banking products on financial performance the results partially concur with the theory of Islamic banking.
CHAPTER ONE
INTRODUCTION

1.1 Background of the Study
Small and Medium Enterprises (SMEs) are key for every nation, especially the emerging economies. Prescribed SMEs make up 45 percent of aggregate jobs and equal to 33 percent of developing nations’ national income (GDP). These figures are substantially greater when informal ones are incorporated. As per evaluations, there will be a call for 600 million jobs in the coming 15 years to take in the swelling worldwide labor force, majorly in Asia as well as Sub-Saharan Africa. In developing economies, numerous formal jobs are by SMEs, that similarly form 4 out of 5 new spots (Hussein, 2016). But, funds obtainability is the primary constriction to their growth; lacking it, numerous SMEs fail and languish. They constitute a substantial element of a nation’s economy and offer job prospects for several individuals. They are not much expected to obtain bank credit relative to outsized enterprises; as an alternative, they hinge on individual finances to take-off and primarily do their operations. 50 percent of prescribed SMEs cannot gain proper lending. This funding gap is even bigger when undersized as well as informal businesses are considered. Generally, nearly 70 percent of developing nations’ MSMEs cannot obtain loans. Whereas the gap ranges substantially between counties, it's predominantly extensive in Africa as well as Asia (Mumani, 2014).

Islamic finance fosters the development of financial sector and widens financial inclusion. Through mounting of the variety of financial products as well as their obtainability, Islamic finance is key in enhancing funds access and encourages the inclusion of the underprivileged of financial services. Loaning of SMEs by banks appear to be personalized for Islamic banking procedures grounded on affiliation lending contrasted with other highly traditional approaches of credit funding. A major competitive value of this method is a real cost benefit owing to cut evaluating charges. Though, the kind of the agreement could similarly offer prospects for boosted growth and further quality benefit hinged on the bearing of security, superior managerial skill as well as lowered information unevenness. Islamic banking and Islamic financial products utilization has amplified considerably in recent past. A true cost benefit ought to offer Islamic banks a position in the marketplace for loaning SMEs. A further quality benefit implies that this
benefit could possibly be highly penetrating as the Islamic banks’ market share may grow radically in standard depicting the entire marketplace. (Shaban, Duygun, & Fry, 2016)

The Islamic banking scheme begun as a competitive as well as a practical alternative to the traditional banking scheme. Islamic Banking has considerably grown to become among the sound and actually determined to be among as the globe’s fastest-developing economic segments. This segment is considered by banking processes without interest rate and is hinged on the fundamental principle of justice as well as sharing of risk (Benhayoun et al., 2014). Islamic banking emanated from Islam which inhibits resources concentration in the minority hence the importance of Islamic banking scheme is to link the gap between the well-off and the underprivileged by adapting the economic resources allotment supportive of the underprivileged (Ismail, 2010).

1.1.1 Islamic Banking Products

The concept of Islamic banking and finance is normally viewed from the perspective of the proscription of gharar (uncertainty) as well as liberty of agreement (Bashir, 2011). Consistent with shariah, gharar is an aspect of gamble encompassing lop-sided facts, uncertainty, possibility or even conjecture resulting in unlawful profits, for example is disqualified by the religious as well as accordingly by the human notion of Islam. Islam gives complete liberty of agreements to financial go-betweens provided that the subsequent agreement conforms to definition by shariah that primarily disregards riba (interest) as well as gharar. Owing to the liberty of agreements as well as the apprehending of gharar, Islam entirely is aware of risk created by financial and commercial aspects as well as features extrinsic to the establishment of enterprise. Amongst the Islamic funding approaches as well as financial products entailing risks are murabahah, mudharaba, and musharakah. In traditional banks, account holders have a permanent entitlement on the bank’s assets, as per set interest rates alongside their capital yield. As such traditional bank ought to service its debts to account holders regardless of its definite productivity (gains). Thus, any improbability in the revenue flow produced through and transformation in the bank’s assets value is shouldered by the stockholders only. Contrariwise Islamic banks are controlled on the norm of risk division. This relates to the fund sources and could similarly relate to fund uses. Regarding mudharabah, bearers of income sharing venture
accounts (which substitute traditional interest holding bank deposit accounts) are basically shareholders having a kind of restricted term equity investment. The return on their investment in the bank is uncertain, since they share in the profit generated by the bank alongside the shareholders. This also exposes the investment account holders to the risk of losing any or all of their initial investment.

Islamic finance centers on partnership-style funding that can be essential in enhancing financial access for the underprivileged as well as undersized enterprises. It could as well enable enhancement of agricultural finance, resulting in enhanced food security. Incidentally, Islamic finance is essential in meeting the needs of individuals who presently are not using traditional finance owing to religious explanations. Islamic finance focus attention on partnership-style financing, that can be essential in enhancing financial access for the underprivileged as well as undersized enterprises. It could as well enable enhancement of agricultural finance, resulting in enhanced food security. Incidentally, Islamic finance is essential in meeting the needs of individuals who presently are not using traditional finance owing to religious explanations. Among nearly the 1.6 billion Muslims worldwide, merely 14% make use of banks. It could aid in reducing the whole gap in financial access, as non-Muslims are not forbidden from making use of Islamic financial facilities. Though, the Islamic financial structure, functioning beside the traditional sector, is similarly subjected to generally similar universal risk aspects as well as unpredictability as its traditional counterpart, notwithstanding its continued growth momentum.

1.1.2 Financial performance

The assessment of financial performance is without such a variety of alternatives as well as approaches notwithstanding the significance of financial sustainability. Although a drive for sustainable organizations has frequently been conveyed, there was similarly an alternative that a number of financial establishments operational in this field have not been sustainable. Researches have pointed out that this is principally associated to the discernment of micro debtors risk as well as soundness, and the diseconomies of scale associated with creating small credits (Quach, 2005). According to Dayson et al., (2006), microfinance has been appealing to credit establishments due to proven sustainability as well as low operations cost. Liquidity measures the capacity of the enterprise to encounter financial obligations as scheduled, minus
disruption of the usual, current processes of the enterprise. It could be evaluated structurally as well as operationally. Structural liquidity conveys the balance sheet (assets as well as liabilities) while operational liquidity conveys cash flow metrics.

Conversely Quach, (2005) pointed out that solvency determines the level of loaned out capital utilized by the enterprise comparative to the level of owner’s equity capital financed in the enterprise. Explicitly, solvency metrics give a sign of the enterprise’s capacity to pay back all obligation if all of the assets were sold. Solvency metrics similarly give a sign of the enterprise’s capacity to survive risks by giving facts regarding the enterprise’s capacity to remain in operation following a chief financial difficulty.

Profitability assesses the level to which an enterprise makes revenues from the production factors: management, labor as well as capital. It considers the link between incomes and costs and on the extent of revenues comparative to the investment size in the enterprise. Four key metrics of enterprise’s profitability comprise: return on assets (ROA), return on equity (ROE), operating profit margin as well as net enterprise revenue. The ROA determines the return to all enterprise assets and usually is utilized as a general profitability metric, and the greater the value, the higher the enterprise’s profitability. The ROE determines the rate of return on the owner’s equity put into the enterprise. It is essential to regard ROE with regard to ROA to assess whether the enterprise is generating a profitable return on their loaned out funds (Zenios et al., 1999).

1.1.3 Islamic Banking Products and Financial performance
The Islamic finance sector swiftly grown in the past few years, having more than 15% annual growth rates. In a number of Muslim nations, Islamic banking assets have been fast up surging compared to traditional banking assets. The underlying principles Islamic finance of supporting sharing, property privileges, equity as well as ethics are all general principles. However, notwithstanding these key advantages and the unblemished prospects, there is remains to be much to achieve the utmost prospective of Islamic finance. Currently, it is below 1% of worldwide financial assets and remains to be highly focused not in many markets. Hence there is evidently opportunity to mature, particularly because the aspects of its products could possibly attract a much broader population (Hussein, 2016).
Consistent with these doctrines, Islamic finance has established particular financing products (Léon & Weill, 2016). Firstly, two essential financing products are collaboration agreements between the financier and the debtor on the basis of the profit-and-loss-dividing rule: musharaka, and mudaraba. A mudaraba agreement is grounded the point that the financier offers the funds and the borrower gives work as well as knowledge. Incomes are divided between the parties, while the financier endures all the losses. In a musharaka agreement, incomes as well as losses are divided up between the financier and the debtor since both parties have contributed funds. Secondly, murabaha is a mark-up transaction hinged on the point that the financier purchases a good and sells it to the client for a value that consist of the initial cost and a certain margin. It ought to pointed out that the price could be paid in various payments, making murabaha identical to a credit bearing interest from the debtor’s standpoint. However dissimilarities exist between both systems of funding. Conversely, the interest absent as the return relates to the sale of an item rather than money. Also penalty charge for default is proscribed. Lastly, ijara reflects the traditional leasing agreement in Islamic finance. The financier purchases an item then leases it to the client for a given duration and a particular rent. Therefore the bank is not able to make money from funds as per Islamic rule since it translates funds into physical assets to do the transaction. Although Islamic Finance is known and has been undertaken for years worldwide, it has become popular in the recent years. Aggregate Islamic finance assets are projected at nearly $2 trillion, almost a ten-fold upsurge from few years ago, and overtaking the traditional finance growth in several regions.

1.1.4 Small and medium enterprises
The term Small and medium enterprises (SMEs) embroils several definitions, that vary in relation to aspects for instance nation’s geographic area, development level and enterprise culture. Even within nations, meanings could differ. The precise needs as well as setting of their program portfolios usually determine such meanings. Numerous standards applied to describe SMEs, for instance the workers number, annual sales, asset size, or annual productivity (Elasrag, 2010). SMEs are commonly acknowledged as the economy drivers and the Key contributors to gross domestic product (GDP) around the globe, including those countries in Africa and East Africa region especially Kenya. These businesses create employment opportunities for both skilled and unskilled person. However, market conditions such as Banks’ strict procedures in
Obtaining financings or credit facility and regulatory environments are not always supportive of the growth of SMEs these are one of the main obstacles they face.

Nearly 60-70% of the businesses in Nairobi are SMEs. The growths of SMEs business are thereby mainly dependent on lending or financing offered by commercial banks that exist in the city. Although these have had an impact on the SME growths, more and more business has been dwindling downwards due to exorbitant interest rates that have locked out many business. Some businesses also collapsed due to unfavorable market conditions. Other condition such as complex credit procedures, provisions of collaterals for facilities to be borrowed has been the hindrances for SMEs to accesses financing.

The growth of SMEs has also been hindered by Market inflations that keep on altering the commercial banks rates; therefore there is a demand for Islamic Shariah banking and innovations such include ‘Murabaha’ ‘Mudarabah’, ‘Musharakah’ and ‘service Ijara’ which are unique to Islamic banking and that affect positively the SMEs environment. Islamic banks simplified the mode of banking by doing business free of interest thus leading to high competition among the banking industry and the scrabble for SME customers that contribute to the largest customer segment in the banking industry. The Kenyan banking sector has been in a stiff competition to capture the SME market; this has impacted the growth of the SME business in the country. Islamic banks in Kenya has also played major role in the growth of SMEs with the two fully fledged Islamic banks.

1.2 Research Problem

The performance of an economy as well as impending prospects is an issue of growing attention amongst policymakers at both local and global scope. This indicates that several nations, SMEs make up the vast widely held enterprises and are key employment. Sources. Additionally, SMEs, mainly start-up, have continues to be net jobs growth contributors since the 2008 financial crunch, and the reason for focused attention on SMEs performance turns out to be well-defined (International Trade Centre, 2015). SMEs are key in employment creation as well as revenue generation; they constitute nearly 70% of all employment prospects globally.
With the socioeconomic worth of SMEs, their significance as well as influence are not proportionately met with backing systems as well as networks that would foster the progression of present SMEs, and the setting up of new ones, and which would enhance their socioeconomic worth even more. SMEs worldwide particularly in emerging economies encounter problems that are, to a great level, identical and comprise restricted financial access, huge transaction costs, as well as inadequate capable personnel, detrimental legal as well as regulatory situations, inadequate technological as well as markets access. Hove, Sibanda and Pooe (2014) established that Islamic banking bore a positive and significant influence on business drive as well as enterprise competitiveness in South Africa. The study indicated that through Islamic banking, SMEs were able to access credit at lower interest rates through customer relationship management and profiling. In another study, Tuitoek (2012) established that offering sharia compliant products have improved the financial performance of in Kenyan commercial banks. Salim (2014) identified numerous ways of funding employed by Islamic banking including diminishing Musharaka, Ijara and Murababa.

Islam, Yousuf and Rahman (2014) performed a comparative investigation of traditional and Islamic banks by looking at SME financing in Bangladesh. The findings indicated that outlay of SMEs credit by each of the considered traditional bank showed nearly 1.5 times upsurge from 2009-2011 as compared to outlay of SMEs credit by all Islamic banks that portrayed nearly 1.35 times upsurge. These studies explored other aspects of Islamic banking from different contexts which therefore limit their application in the current study. This therefore leaves a research gap that this study sought to fill by analyzing the research question, what is the effect of Islamic banking products on the performance of SMEs in Nairobi County?

1.3 Research Objective
To measure the influence of Islamic banking products on the financial performance of small and medium enterprises in Nairobi County.

1.4 Value of the Study
The research may offer worthy benefits from hypothetical as well as real-world perspective. From a hypothetical stance, it adds to the broad apprehending of Islamic banking products the dynamics impinging the financial performance of SMEs in Nairobi CBD
The aim of the Islamic products to ensure the daily planned operations of the bank are accomplished. The outcomes of this research will be essential to: Banks senior administrators since it will offer direction on the structure of administration as well as recognition of the products by decision makers in the banking sector. Commercial banks’ employees partaking the everyday operations will be capable of drawing conclusion to the research in selection of places of enhancements.

The research results will possibly allow the Kenyan Islamic Banks’ administration to enhance their administration practice as well as to embrace effective strategies to enhance enterprises’ financial performance by way of the risk controlling procedures. This could possibly allow the Islamic Banks to boost their performance as well as to develop their companies and uphold a competitive advantage.

Finally the regulator (Central Bank of Kenya) may use this study to design and improve on the current management framework for all SMEs in Kenya. The research could similarly augment the current form of understanding on Islamic finance. This may benefit academicians and other researchers by providing materials that form the basis for further research on Islamic finance.
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction
This part illustrates hypothetical as well as experimental material from literature on subjects pertaining to the study problem. It summarizes the literature from other scholars who have undertaken their research in the similar area of Islamic banking products and its effect on the performance of SMEs.

2.2 Theoretical Review
This investigation will analyze the profit as well as loss sharing concept, concept of Islamic banking, entrepreneurship and innovation concept of Islamic banking.

2.2.1 Profit and Loss Sharing Theory
Instruments like mudarabah and musharakah are deemed the basis of the Islamic banking concept (Faraq, 2010). Pertaining to banking under mudarabah, the Islamic bank takes finances from account holders under risk-sharing provisions. The bank either openly puts in these finances in gainful investing or outspreads them to businesspersons on the basis of dividing risk. The bank divide up the earnings or loss suffered on mudarabah schemes with its account holders (Gamal, 2006).

In musharakah, the Islamic bank gives the account holders’ finances to a shared enterprise with the customer (businessperson). Usually, the Islamic bank lets the consumer control all the undertakings of a Musharakah enterprise (Hassan & Mervyn, 2009). The Islamic bank and the customer equally divide the profit or loss from the Musharakah venture. In a normal PLS agreement, an Islamic bank gives an enterprise the risk capital under which proficient managers are in charge of strategic as well as operational decision making. The bank divides incomes and is accountable to monetary loss. No severe issue exists with this agreement if the bank can, and is permitted, to scrutinize the undertakings of the enterprise. The profit and loss sharing theory has been faulted as a result of lack of proper monitoring mechanisms particularly in circumstance of Mudarabah that does not give any control privileges to the venture capitalist (Iqbal, 2011).
Literature of the Profit and Loss sharing dates back in 1986. According to Saleh (1986), there are three privileges and one obligation of the venture capitalist in a Mudaraba agreement. The privileges comprise making sure that the borrowing businessperson (enterprise) conforms to the contract requirements, sharing gains, as well as limited liability in loss situation. The single obligation is administering over the capital in Mudaraba. He as well underlines two privileges and two duties of the borrower. Privileges comprise operating the enterprise with a proper level of freedom, as well as decisions on bookkeeping. The obligations are conformity to the contract requirements, as well as Mudaraba business liquidation at the contract’s expiration.

The current Mudaraba use as a means of funding certainly needs beyond such initial description of privileges and obligations. Research by Okpara (2009) notes the importance of creating consistent PLS contracts, or guidelines, with regard to the legal outlines of Islamic states. A noticeable aspect of these guidelines ought to be description of the privileges as well as duties of different groups within the enterprises structure. Comparable regulations ought to outline the sections pertaining to the borrowing enterprise’s performance relative to other enterprises in the same industry and, perhaps, other enterprises.

2.2.2 Theory of Islamic banking

The Islamic banking concept is hinged on the notion that interest is stringently prohibited in Islam, and as such Islamic traditions offer the needed direction in which to establish the functioning of banks (Hassan & Lewis, 2007). According to Ahmad (2006), the Islamic banking concept is hinged fundamentally on the principle that interest, which is stringently prohibited in Islam, is neither an essential nor a desired ground for the undertakings of banking processes, and as such Islamic traditions offer better grounds for establishing the functioning of banks. The basic assume that has directed all hypothetical material on Islamic banking is that whereas interest is prohibited in Islam, business as well as revenues is allowed. The fundamental law in Islamic principle is that unfair deals or biased conventions that encompass gamble are not allowed (Hassan & Lewis, 2007).

Theoretical material on Islamic banking embroils several factors pertaining to the working processes of Islamic banks as well as the potential socioeconomic implications of the use of the new structure (Ahmad, 2006). Islam seeks to establish a culture guided by fairness as well as
justice (Holy Qur’an 2:239). Thus, Islamic banking concept has progressed on the grounds that direction for every established development in an Islamic culture ought to originate from the doctrines of Shari’ah. The aspects of Islamic banking guidelines have, then, to originate from the traditions of Islam (Ahmad, 2006). For instance, if a credit offers the creditor a static yield regardless of the result of the debtor’s enterprise. It is considerably reasonable to bear a division of the gains as well as losses. Equality in this situation has two aspects: the venture capitalist holds a privilege to reward, however this reward ought to be proportionate to the risk as well as work put and therefore be overseen by the yield on the specific venture for which finances are given (Hassan & Lewis, 2007).

2.1.1 Entrepreneurship and innovation theory

The hypothesis was familiarized and advanced by Joseph Schumpeter (1838-1950). The initial concept emphasized on innovation’s role on entrepreneurship, economy as well as social revolution. Schumpeter contended that, the economy by way of fixed lenses considered the dissemination of particular resources across various infrastructures. Schumpeter’s view of economic development is perceived as a course of qualitative transformation compelled by novelty happening in historical time. Giving instances of invention, Schumpeter stated novel products, production methods, resource sources, markets exploitation, as well as means to organize enterprise. He termed innovation as a new combination of current assets. Through these combinations, he described the entrepreneurial meaning. For effective innovations, he stated the key part that entrepreneurs play. Specifically, the occurrence of sluggishness or opposition to innovative ways at each society level that entrepreneurs had to battle so as to become successful in their goals. Rafinejad, (2007) terms the Schumpeter’s concept as the one that lays emphasis on innovation overlooking risk taking as well as an entrepreneur controlling capabilities. The theory of entrepreneurship is key to this research since it defines the association between novelty and entrepreneurship.

Innovations as understood in the concept bring about economic as well as social transformation. Contrariwise, novelty has offers prospects through which businesspersons could possibly develop novel products, new production ways, new resources, new markets and new ways to consolidate enterprise. In the study perspective, mobile banking offers prospects for banking
establishments to establish new ways of undertaking business, which are likely to foster economic as well as social transformations within the customer fraternity. This is revealed in the manner in which banks presented new product and services because of the innovation, trends of embracing the novelties amongst clients as well as challenges faced in the adoption.

2.3. Determinants of the Financial Performance

The key measure of financial performance is profitability; it is the relationship of income to some balance sheet measure which indicates the relative ability to earn income on assets. Performance to banks refers to the capacity in generating sustainable profitability (Wild, Shaw & Chiappetta, 2009). Muthini (2005) conducted a study on the determinants of banks profitability in Kenya by empirically evaluating the link between internal and external determinants over profitability over a period of ten years (2002 to 2012).

2.3.1 Islamic Banking Products

Islamic banking can mobilize various forms of deposits such as wadi’ah (safekeeping), qard al-hassan (benevolence loan) and mudaraba (profit sharing) (Siddiqui, 2001). Under wadi’ah mechanism, the deposits are held as amanah (trust) and utilized by the bank at its own risk. The depositors are not entitled to any return since the profit or loss resulting from the investment of these funds is entirely belonged to the bank. Another model is using qard al-hassan mechanism, whereby the funds deposited in the bank is treated as a loan by the depositor (Siddiqui, 2001).

Here, bank shall have to guarantee the principal amount but is not allowed to offer any return to depositors. Islamic microfinance initiative may also mobilize funds through participatory models such as Musharaka and Mudaraba. There is a great potential to attract depositors amongst the rich who intend to do charity via Islamic participatory approach of risk and profit-sharing. In Musharaka model of fund-raising, public can buy shares and become owners of the whole microfinance programme initiated by Islamic banks or choose specific financing project of their choice. Islam offers mechanisms for redistribution of income and wealth and enhancement of social inclusion, so that every Muslim is guaranteed a fair standard of living (Metwally, 1997).
Islamic banks can offer a wide-array of Shari’ah-compliant financing instruments addressing various needs and demands of the client especially among the poor entrepreneur these instruments can be broadly divided into: participatory profit loss sharing modes like mudaraba and musharaka; sales-based modes like murabaha (cost plus sale), lease-based modes like Ijarah and benevolence loan (Siddiqui, 2001).

2.3.1. Access to Finances

The major commonly specified difficulty for SMEs is their inability to obtain credit/finance. Financial limitations function in numerous ways where different capital market influences businesspersons to depend on self-funding or from groups of people, is inadequate to allow SMEs to optimally do their operations. Lacking access to long-term funding for SMEs has compelled numerous Kenyan SMEs to depend high cost short term funds. The numerous funding problems encountered by SMEs embroil: high credit cost, huge bank costs and fees as well as lack of appropriate set-up (Kauffmann, 2005).

Wanjohi and Mugure (2008) established the level entrepreneurs’ demand for loans amongst the common and small earning enterprises as various creditors for pyramid schemes established, pledging hope amongst the ‘small business people,’ that they could pull through to the financial liberty by way soft credit. The motive for choosing these schemes amongst a substantial number of businesspersons was primarily to look for funds and soft loans bearing low interest rates while generating revenues. Financial constriction is still a key problem that SMEs in Kenya encounter.

2.3.2 Risk Management

A number of financial establishments depend on conventional banking methods to ascertain and mark sustainable SMEs. Financial establishments should include appropriate credit assessment procedures (for instance behavioral recording, credit recording, as well as cash flow and program based loaning) and create robust primary cautionary methods as well as collections structures to target as well as manage SMEs effectively, price products more efficiently, as well as lessen exposure to risk. Simplify loan request procedures for SMEs: SMEs encounter problems in requesting for credit owing to the quantity of papers necessary as well as the extensive consent course (beyond a month).
Numerous SMEs don’t have the credentials needed to request for a credit. The financial necessities of SMEs are crucial relative to those of big businesses. Consequently, the consent course ought to be reduced. Islamic banks ought to simplify procedures and consider establishing interactions with SMEs (current as well as potential clients), that would ensure prompt provision of loans. So as to obtain the necessary capabilities for sustainable, profitable, as well as high performing Islamic SME portfolio, banks could possibly require to look for professional support.

2.3.3 Products and Services

Conventional products can now enable banks to obtain the needed measure for a gainful Islamic SME selection. Therefore, it would be key to modify current corporate as well as retail banking products and, more decisively, develop product plans as well as portfolio methods. Proposing no-borrowing services: Islamic banks ought to expand offerings of products as well as services by giving non-borrowing services for instance cash administration, payroll administration, payments, collections, as well as enterprise finance help. Internet banking as well as mobile banking services ought to similarly be taken into account alongside requirements for SME-specific debit cards with day-to-day parameters.

2.3.4 Availability of Business Information

For the SMEs sector in emerging economies, Kenya being an example to witness sustainable growth as well as development levels, accessibility to business information services has been recognized to be an instance that requires from governments’ as well as enterprise services providers’ attention. Numerous Africa SMEs particularly Kenya, function in a situation where the information is insufficient owing to inadequate enterprise support services as well as unsound IT infrastructures (Oshikoya and Hussain, 2007). Information access has nevertheless is still not offered similar attention compared to other constrictions to enhance SMEs performance for instance to funds, markets and technological access (Kauffmann, 2005).

SMEs’ obtainability of business data services presently has been boosted with the development of numerous ICTs. In industrialized economies, SMEs benefit from availability of business information services owing to well-developed ICT infrastructure and as well as obtainability
computer hardware and software whereas in emerging economies numerous challenges prevail on ICT infrastructure as well as IT hardware and software costs.

2.3.5 Management Efficiency

Management Efficiency is an essential internal aspect that impinges profitability of the bank. It is characterized by various financial ratios for instance loan growth rate, total asset growth, as well as revenues growth rate. Operational efficiency in management of the operating costs is also an aspect of quality management. Management performance is usually conveyed qualitatively using particular assessment of management systems, control systems, organizational discipline as well as employee quality. However, some financial ratios of the financial reports are a representation of management efficiency. The management’s capacity to efficiently organize its resources, revenue maximization, cutting operating overheads could be assessed by financial ratios. Among ratios employed in evaluating managing quality is operating revenue to revenue percentage (Rahman et al. in Ilhomovich, 2009). The greater the operating incomes to aggregate returns the greater the management proficiency with regards to operational proficiency as well as revenue generation. Another key ratio is that representation management eminence is costs to asset ratio. The ratio of operating costs to total asset should be adversely linked to profitability. Management quality in hence, establishes the operating costs and sequentially impinges on effectiveness (Athanasoglou et al.2005).

2.3.6 Liquidity Management

Liquidity is similarly an aspect that evaluates bank performance level. Liquidity is the bank’s capacity to realize its debts, majorly account holders. Dang (2011) notes that satisfactory liquidity level is absolutely associated to profitability of bank. The commonly employed financial ratios replicating bank’s liquidity position consistent with Dang are client deposit to total asset as well as total credit to client deposits. Some academics employ various financial ratio to evaluate liquidity. For instance Ilhomovich (2009) utilized cash to deposit ratio to assess Malaysian banks’ liquidity level. Though, the research undertaken in China and Malaysia pointed out that banks’ liquidity level lacks a link with their performances (Said and Tumin, 2011).
2.3.7 Credit Terms

Credit terms refers to the standards that commercial banks apply in determining the ability of clients to repay their loans and when it matures. Credit terms help financial institutions in gauging the credit worthiness of the customers while hedging against the risk of loss in case of non-repayment from the side of the borrower. Funds for SMEs growth from different financial institutions come with different terms. Credit terms usually state the credit period, the credit limit, the interest rate, and method of calculating interest and frequency of loan installments especially in a non-Muslim banking institution (Wachira, 2015).

Availability of conducive credit terms influences the uptake of loans among SMEs in Kenya and this positively affects their growth and financial performance. Most SMEs tend to greatly benefit from the Islamic banking system since the credit terms are conducive and convenient. This is because Islamic banks are simply permitted to amass the sum equal to the lent principal sum (Aburime & Alio, 2009) and as such, the credit is almost interest free.

2.3.8 Macroeconomic Factors

The stability of macroeconomic policy, GDP, Interests and Inflation rates as well as political instability are among the macroeconomic aspects that impinge on banks’ performance. For example, GDP trend impinges on the banks asset demand. In the falling GDP growth credit demand declines which sequentially negatively influences banks’ profitability. Contrariwise, in an accelerating economy characterized by optimistic GDP growth, credit call is high owing to the environment of business phase. In booms the credit call is high relative to downturn (Athanasoglou et al., 2005). They similarly note with regards to the Greek scenario that the link between inflation level and banks effectiveness is still controversial. The link’s direction is not defined (Vong & Chan, 2009).

2.4. Empirical Review

Kadubo (2010) verified the factors impinging on the growth of Kenyan Islamic banking. The research adopted a case study of four Kenyan Islamic conforming banks, which included Dubai Bank, First Community Bank, Gulf African Bank, KCB Ltd and Barclays Bank Ltd. A sample of 33 clients, depositors in their individual banks as well as 11 executives were involved. Data was
sourced by way of questionnaires. The results pointed out that Islamic banking compliant was determined by religious conformity and clients requirements being satisfied. It similarly verified that constant evaluation as well as enhancement of Shari’ah compliant products alongside differentiating market position would result in far-reaching improvement as well as Islamic banking products’ marketing. The research determined that the aspects impinging on growth of Kenyan Islamic banking products are simply religious conformity and clients requirements being satisfied.

Daud, Yussof and Abideen (2011) examined the discernments of Nigerian Muslim Youths in Malaysia on the apparent responsibility required from the Central Bank of Nigeria in the institution and setting-up of IBs in Nigeria. The study sought the students’ discernments in three Malaysian universities namely; Universiti Utara Malaysia, Kolej Universiti Insaniah and International Islamic University Malaysia. The sample of the study comprised 100 students. Among the issued questionnaires 85 were completed and returned. The data obtained was analyzed by way of the SPSS version 18. The results pointed out that the responsibility of the Central Bank of Nigeria in the instituting and operation of IBs in Nigeria is not substantial. Also it was verified that of Nigerian Central Bank ought to support sufficient research in IBs, the legal framework of IBs should be further strengthened and that the Central Bank of Nigeria ought to work together with the Judiciary for the instituting Shari’ah courts to decide IBs cases. Alam (2015) states that SMEs’ limited access to finance reflects the interaction of demand, supply, regulatory, institutional, and other policy factors that are a hindrance for the growth of SMEs. Growth is also hindered in those countries with well-established Islamic banking by the lack of appropriate Islamic finance offerings for SMEs. On average, around 35% of SMEs in Middle East, North Africa and Pakistan according to the study are not borrowing money to grow their businesses despite the significant demand due to the lack of Islamic finance. Several researches have been undertaken on Islamic banking and its influence on growth of SMEs under various factors.

Abdulkadir (2016) wrote a paper on Islamic Finance in Sub-Saharan Africa - new impetus, and projections for growth in the continent and stated that some of the challenges in regions businesses include the lack of funding and the necessity to have an inclusive financial services access. Inadequacy of funds to start or accelerate the growth of a business is a hindrance to the
development of many SMEs and entrepreneurs. This can be countered by using Islamic banking as a stimulant for financial inclusion in Africa and it becoming a key financial capital source for small businesses and entities.

Yusuf and Mobolaji (2012) explored the Nigerian experience of Islamic micro insurance in alleviating poverty impartial of the Central Bank. The study adopted a case study of the Al-Baraka microfinance Bank in Lagos and analyzed its performance and role since its launch. The focus was whether the Shariah-compliance is a positive aspect the realization of the goal of alleviating poverty by the government. To obtain a comprehensive insight of the capability of Nigerian Islamic micro-insurance, qualitative study using explorative study was undertaken. The study utilized both primary and secondary data to explore the Al-Baraka microfinance house’s performance. The study findings established that Islamic Micro Insurance Company was doing better than its conventional counterparts were.

Akinyi (2015) states that credit access for working capital as well as long-term venture drive is still among the key challenges that SMEs encounter in their processes whether in Kenya and other emerging economies. The working capital to channel entrepreneurs’ ideas to actions is a huge constraint to SMEs. Using bank financing SMEs can get the funds they need to for start-up and development. In this case Islamic Banking is even better for start-up capital since it has low interest rates that do not steer entrepreneurs to seek informal forms of lending.

Alam (2015) identifies that most SMEs approach banks for working capital requirements. This is very instrumental in the growth of a particular business as it enables a business owner to launch his/her idea and nature it into growth. Nondi and Achoki (2006) conducted a study of financial management issues in Kenyan restaurants; established that 26% of these entities indicated lack of working capital to be the key issue they encounter in their undertakings. The study further identified that the provision of working capital by banks would be effective in enhancing the financial performance of the business.

Alhafi (2015) in the study titled SMEs opportunities for Islamic Banks indicated that most Islamic banks have branding and marketing lapses of SME products as many SMEs are uninformed of the disposal of those products from the financial establishments. Consequently, Islamic banks have not been capable of properly servicing the SMEs despite having the
appropriate products for SMEs. With the right focus and the right use of these processes, products and services, Islamic banks can tap this huge potential.

Chong and Liu (2009) researched on whether Islamic banks are indeed interest-free, using Malaysian experiences as a case study. Their findings suggest that gains and loss sharing schemes is indeed the distinguishing characteristic of Islamic banking although they tend not to be as important as a mode of financing on the assets side of the financial statement. While the financing arrangement on the deposit-side is theoretically a profit- and loss-sharing contract, pay-outs tend to be closely pegged to rates on conventional deposits. They also found that there exists little dissimilarity in substance between Islamic and traditional banks. Contrasting traditional banks, Islamic banks do earn fees and commissions relating to services beyond traditional deposit and loan financing activities.

A research undertaken on the determining factors of growth of Kenyan Islamic banking by Kadubo (2010), established Islamic banking was determined by religious conformity as well as clients’ requirements being satisfied. It similarly pointed out that constant assessment as well as enhancement of sharia compliant products alongside differentiating market position will result radical growth as well as promotion of Islamic banking products.

Mustafa (2013) explored the effects of Islamic banks on financial development among Muslims in Kenyan. The research utilized a descriptive research design and a sample of 384 Muslims was utilized. Questionnaires were employed to collect data. The regression model was adopted to verify the association between the variables. The investigation established that lack of access to financial information service affected the growth of Islamic banking. In addition, the study ascertained that government policies, regulations, and technological changes affected the development of the financial institutions. Further, the study found out that customers face issues of amassing capital, obtaining funds and loans and recommended that is need for enhanced support for knowledge visits to boost the information stream, the government ought to establish policies on businesspersons’ training.

Saida (2014) investigated the factors that impact adoption of Islamic banking and financial services in Kenya. The study adopted a descriptive survey design. A sample of 125 respondents from four Islamic and traditional banks in Nairobi was utilized. The results pointed out that vast number respondents were aware and well-informed of Islamic banking as well as financial
products. Religious attachment was revealed to be a key drive for selecting Islamic banking as well as financial services. Other drives entailed: offering of low-cost products; banks’ convenient locations as well as other ethical motives. The ease of banking followed by the interest levels ranked top amongst respondents with regards to services differentiation by various banks. Customers similarly opted for banking establishments: holding higher confidentiality levels, offering financial guidance, offering prompt as well as well-organized transactions. They were also least focused on whether the bank offered Islamic banking or financial services.

Wako et al. (2014) conducted a study that sought to ascertain the challenges influencing Kenyan Islamic banks performance. The research adopted descriptive survey to obtain employees views on the challenges impelling Islamic banks’ performance. The target population comprised 250 Islamic banking employees in Nairobi. This investigation used random sampling approach. It found out that global economy changes, advancement in information technology, the difficulties of legal and institutional framework, weak risk assessment and management, unsound corporate governance standards as well as unsound personnel practices were major factors affecting Islamic commercial banks performance in Kenya. There is adequate scope of literature established around numerous Islamic banking aspects broadly and particularly on GCC.

2.5. Conceptual Framework

Saunders (2007) state that conceptual framework, are organized from a series of comprehensive concepts that enable a researcher to appropriately ascertain the problem under investigation, structure their questions and identify appropriate literature. As stated by Young (2009), conceptual framework is a clear illustration that indicating the link between the study variables. The major elements are theories or variables and the supposed link among them.
2.6. Summary of the Literature Review

This section has looked at the works from different scholars on the research objectives. It covers sections the factors impinging on the performance of SMEs in terms of Islamic banking products, financial access as well as the financial performance. The subsequent is section illustrates research methodology distinctly describing the approaches adopted to source the needed information, research design as well as the manner in which data analysis was performed.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1. Introduction
This part illustrates a summary of different methods and tools used gathering data to attain the goal of the research. It illustrates the research design, it state the target population, sample design, highlight procedure of data gathering and analysis.

3.2. Research Design
In relation to Orodho (2003) research design is a plan, arrangement as well as scheme of study to find answers to research questions as well as control variance. A research design is the outline, or blueprint utilized in generating answer to study problems. A descriptive investigation was employed to perform the research. It is a way of gathering material through interviews or dissemination of questionnaire to respondents sample (Orodho, 2003). Descriptive research embroils obtaining information that explain occurrences and then arranges, presents and illustrates the data obtained (Glass & Hopkins, 1984). Their aim is to establish "what is," hence observational as well as survey approaches are often employed in gathering descriptive information (Borg & Gall, 1989).

3.3. Target Population of the Study
Cooper and Schindler (2003), term population as the subject which is evaluated hence it is an element of assessment. It is where the assessment is drawn. A sample is the subgroup of characters from a population which is utilized to obtain an evaluation of the features of the whole population. This study population encompassed 4,560 SMEs in Nairobi County. The researcher pile up a record of all the SMEs and the most suitable SMEs were picked as the respondent for this research.

3.4 Sampling
Cooper and Schindler (2008) state that sample size is the smaller unit of the whole population. The significance of having a sample size owing to it being cost-effective for the researcher in obtaining data. This research sourced sampling frame from Ministry of Industrialization and Trade Development. When the investigator confines examinations the population, it could be inefficient as it produces outcomes that are an insufficient demonstration of the whole population size while too big population size could be uneconomical (Cooper and Schindler, 2008). With a
90% confidence level the margin of error is 10%. To get an adequate sample size in relation to the study aim, the researcher utilized Yamane’s formula which is:

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

Where:
\( n = \) the sample size, \( N = \) the population size and \( e = \) the margin of error (Yamane, 1967).

\[ N = \frac{4560}{1 + 4560(.1)^2} = 100 \]

A sample size of 100 respondents will be appropriate to examine as well as attain the specific study objectives.

### 3.4. Data Collection

The research utilized primary and secondary material sources. Secondary data was gathered by the data collection form that that was administered to the management of the SMEs. Secondary data from published financial statements was be used. Secondary data on the performance of SMEs for financial years 2012-2017 was be obtained from the available financial reports of SMEs.

### 3.5. Diagnostic Tests

The sort and the depth of the link between the independent and the dependent variables in the linear regression model was scrutinized by numerous diagnostic tests like tests for multicollinearity, normality, test of independence of observation and the test of homogeneity of variances. The Durbin Watson statistic was used to measure the serial link or autocorrelation whereas the variance of inflation was utilized to examine multicollinearity, skewness and kurtosis was used to check whether the data is normally distributed. In addition, a residual plot was used tom test for homogeneity of variance.
3.6. Data Analysis

Burns and Grove (2003) note that data analysis is a way of decreasing and consolidating data to yield results that need researcher’s elucidation. This involves coding, editing, data entry, as well as evaluation of the entire procedure of data processing. The material collected was scrutinized by way of descriptive statistics and the outcomes was exhibited with the aid of descriptive analysis for instance mean, frequency distribution, percentages as well as standard deviations. Data analysis was undertaken by Statistical Package for Social Sciences (SPSS). Inferential statistics for instance multiple regressions and Pearson correlation would be used. Multiple regressions was employed to verify the nature of association between the study variables.

3.6.1 Analytical Model

Regression analysis was performed using an econometric model below.

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon \]

Where:

\[ Y = \text{ROA (Dependent variable)} \]
\[ \alpha = \text{Constant Term Y-intercept} \]
\[ \beta_1, \beta_2, \beta_3, \beta_4, \beta_5 = \text{Beta coefficients} \]
\[ \varepsilon = \text{Error term.} \]

\[ X_1 = \text{Amount of Musharaka (Natural Logarithm)} \]
\[ X_2 = \text{Amount of Mudaraba (Natural Logarithm)} \]
\[ X_3 = \text{Amount of Murabaha(Natural Logarithm)} \]
\[ X_4 = \text{Amount of Injara(Natural Logarithm)} \]
\[ X_5 = \text{Amount of Tawarruq(Natural Logarithm)} \]
\[ X_6 = \text{LN of Total Assets (Control Variable)} \]

3.6.2 Test of Significance

The coefficient of determination R2 is calculated to ascertain the model’s explanatory strength and how well data fit into the statistical model. The F statistic is calculated to ascertain the models’ significance in entirety. Analysis of variance (ANOVA) tests is utilized to measure experimental data to test the variables for statistical significance.
CHAPTER FOUR
DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction
The investigation’s overall purpose was to determine the effect of Islamic banking products on the performance of SMEs in Nairobi County. The outcomes of the investigation were summarized under the sub-sections: background information, Islamic banking products, financial performance of the SMEs and the association between Islamic banking products and financial performance. Percentages, frequency distributions, mean, standard deviations and correlation values were utilized in presenting the findings.

4.2 Data Analysis
Secondary data on SMEs using Islamic products was considered in the analysis for the period 2012-2017. Different Islamic financial products formed independent variables under study. The analysis is discussed hereunder

4.2.1 Descriptive statistics
Descriptive methods embroiled maximum, standard error of estimate, minimum, mean, skewness and kurtosis. Mean is an extent of central tendency for describing the most usual value in a series of values. The standard error is a statistical word determining the precision in a series of values. Skewness determines evenness, or more specifically, the absence of evenness. A distribution, or data set, is balanced if it appears similar to the left as well as right from the center. Kurtosis determines whether the data are peaky or level for a normal distribution (Cooper and Schindler 2008). The mean and the standard deviation of various Islamic products namely Musharaka, Mudaraba, Murabaha, Injara, and Tawarruq for the period under consideration is in the following Table 4.1
Table 4.1: Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>39</td>
<td>-0.35</td>
<td>0.84</td>
<td>0.32</td>
<td>0.29</td>
</tr>
<tr>
<td>Musharaka</td>
<td>39</td>
<td>14.85</td>
<td>20.65</td>
<td>17.51</td>
<td>1.70</td>
</tr>
<tr>
<td>Mudaraba</td>
<td>39</td>
<td>12.28</td>
<td>18.42</td>
<td>15.18</td>
<td>1.58</td>
</tr>
<tr>
<td>Murabaha</td>
<td>39</td>
<td>11.51</td>
<td>15.61</td>
<td>13.76</td>
<td>1.21</td>
</tr>
<tr>
<td>Injara</td>
<td>39</td>
<td>11.21</td>
<td>15.38</td>
<td>13.50</td>
<td>1.21</td>
</tr>
<tr>
<td>Tawarruq</td>
<td>39</td>
<td>9.28</td>
<td>13.45</td>
<td>11.44</td>
<td>1.17</td>
</tr>
</tbody>
</table>

**Source: Research findings**

The Musharaka had a mean of Kshs 12,964,877 maximum of Kshs 92,533,221, minimum of Kshs 215,000 while the standard deviation was Kshs 19,649,096. The SMEs in Nairobi county use more of this particular Islamic product. Values of mean of the ratio are quite extreme because of a few SMEs. The descriptive statistic in Table 4.1 points out that the mean Mudaraba for SMEs in Nairobi County is Kshs 1,843,139 and the maximum and minimum were Kshs 10,000,000 and Kshs 21,553 respectively. Murabaha for SMEs in Nairobi County is Kshs 162,130 and the maximum and minimum were Kshs 600,000 and Kshs 10,000 respectively. The mean for Injara was Kshs 128,695 and the maximum and minimum were Kshs 480,000 and Kshs 7,400 respectively. Tawarruq had a mean of Kshs 16,953 and the maximum and minimum were Kshs 69,600 and Kshs 1,073 respectively.

**4.2.1 Ownership of the Companies**

The findings on the respondents’ gender were summarized in Figure 4.1 below. From the results, 64% of the companies were under male ownership while 36% were under female ownership. This further indicates that more men than women own SMEs within the Nairobi County.
4.2.2 Age of SMEs

The investigation aimed to verify the length of time the companies have existed. The outcomes as pointed out in Figure 4.2 revealed that most (43%) had existed for between 6 and 10 years. Above one-third (39%) had existed for more than 10 years whereas only 17% had existed for less than 5 years.

Figure 4.2: Age of the SMEs

Source: Field Data (2018)
Figure 4.3 indicates that Musharaka has the highest uses followed by mudaraba and then murabha. Musharaka is at 90% while the others are below 10%.

4.3 Correlation Analysis

Various statistical tests have been performed so as to ascertain whether a link exists between the companies established factors and the dividend disbursement ratio. The key statistical software package employed in the investigation is SPSS. Among the usually adopted tests for measuring the link between variables is Pearson correlation coefficient (Keller, 2005). Pearson correlation determines how strong a linear association between various variables is and the prerequisite when adopting Person correlation is data normality. The extent of probable correlation coefficients extends from -1 to 1. Where -1 points out that an exact negative linear link exists between the variables whereas that of 1 points out that there exists an exact positive link between the variables (Keller, 2005). In an instance the correlation coefficient is equivalent to 0 no link exists between the two variables and they are detached to one another. However is it not often the instance that the correlation coefficient assumes one of the points illustrated above and the association is in numerous instances positioned between the farthest points.

But, even if the correlation coefficient is extensively utilized in in these kinds of investigations, the measurement is imperfect and has certain inadequacies. Among the key inadequacies is that
it simply points out the power of a linear link between two variables, therefore other associations except linear are left out. Also the measurement does not point out the casualty of the association. It simply postulates that an association exists between the variables however it fails to illustrate that one variable results in the changeability of another variable.

The Pearson correlation coefficient is an extent of the power of the linear link between two variables. It is called Pearson's correlation or just the correlation coefficient.

**Table 4.2 Pearson Product Correlation Coefficients (r)**

<table>
<thead>
<tr>
<th></th>
<th>Musharaka</th>
<th>Mudaraba</th>
<th>Murabaha</th>
<th>Injara</th>
<th>Tawarruq</th>
<th>ROA</th>
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<tbody>
<tr>
<td>Musharaka</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>39</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mudaraba</td>
<td>.758**</td>
<td>1</td>
<td></td>
<td>.677**</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
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<td>.000</td>
<td></td>
<td>.000</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>39</td>
<td>.000</td>
<td>39</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>Murabaha</td>
<td>.807**</td>
<td>.677**</td>
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<td>.988**</td>
<td>.986**</td>
<td>.986**</td>
</tr>
<tr>
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<td>.000</td>
<td></td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
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<td>39</td>
<td>.000</td>
<td>39</td>
<td>.000</td>
<td>39</td>
</tr>
<tr>
<td>Injara</td>
<td>.806**</td>
<td>.682**</td>
<td>1.000**</td>
<td>1</td>
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<td></td>
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</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>39</td>
<td>.000</td>
<td>39</td>
<td>.000</td>
<td>39</td>
</tr>
<tr>
<td>Tawarruq</td>
<td>.764**</td>
<td>.655**</td>
<td>.988**</td>
<td>.986**</td>
<td>1</td>
<td></td>
</tr>
<tr>
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<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>39</td>
<td>.000</td>
<td>39</td>
<td>.000</td>
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</tr>
<tr>
<td>ROA</td>
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<td>.256</td>
<td>.530**</td>
<td>.523**</td>
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<td>Pearson Correlation</td>
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<td>.001</td>
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<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>39</td>
<td>.001</td>
<td>39</td>
<td>.001</td>
<td>39</td>
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</tbody>
</table>

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

On the study variables’ correlation, the researcher performed a Pearson correlation. From the correlation analysis outcome between Islamic financial products and performance of SMEs in Nairobi County, the investigation found that a strong positive correlation coefficient existed between Islamic financial products and performance of SMEs in Nairobi County as shown by
correlation factors. It similarly determined a positive association between Murabaha and Musharaka as pointed out by correlation coefficient of 0.807 (P-value < 0.05). Also a positive link existed between Injara and Musharaka as pointed out by correlation coefficient of 0.806 (P-value < 0.05).

As indicated in Wong & Hiew (2005) the correlation coefficient estimate (r) variation between 0.10 and 0.29 is deemed weak, between 0.30 and 0.49 is deemed average and between 0.50 and 1.0 is powerful.

4.4 Regression Analysis
This was performed to ascertain the effect of Islamic products on the performance of SMEs in Nairobi County.

Table 4.3 Regression Model

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.651a</td>
<td>.424</td>
<td>.331</td>
<td>.22063</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Tawarruq, Mudaraba, Musharaka, Injara, Murabaha

The model summary (Table 4.3) indicated that a strong association exists between the study variables. The estimate of R Square was 0.424 indicating that 42.4 % of the changes in financial performance would be described by the independent variables for the study i.e. Tawarruq, Mudaraba, Musharaka, Injara, Murabaha

Analysis in table 4.3 points out that the variables’ coefficient of determination are strong at R=0.651 suggesting that the association between the variables that is, ROA and Islamic products are strong. The proportion change in the dependent variable is described by the variations in the independent that is, R square amount to 0.424, that is, Islamic products explains 42.48% change in ROA. While 57.6 % are variations which are undescribed by the independent variables.
Table 4.4 ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>1.111</td>
<td>5</td>
<td>.222</td>
<td>4.564</td>
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<tr>
<td></td>
<td>Residual</td>
<td>1.509</td>
<td>31</td>
<td>.049</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>2.620</td>
<td>36</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Tawarruq, Mudaraba, Musharaka, Injara, Murabaha

b. Dependent Variable: ROA

ANOVA outcomes (P-value of 0.0003 in table 4.4 show that an association exists between the predictor variables (Tawarruq, Mudaraba, Musharaka, Injara, Murabaha) and dependent variable (ROA). An F ratio is calculated which denotes the change between the groups, as a ratio of the change in the groups. A greater F ratio (F-value of 4.564) points out that there exists higher changeability between the groups attributed to the independent variable compared to in every group, called the error term. The P estimate is 0.003 that is below 0.05 significance level.
Table 4.5: Coefficients of Regression

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
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<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>-1.059</td>
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<tr>
<td>Musharaka</td>
<td>.111</td>
<td>.048</td>
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<tr>
<td>Mudaraba</td>
<td>-.064</td>
<td>.039</td>
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<tr>
<td>Murabaha</td>
<td>-.090</td>
<td>1.489</td>
</tr>
<tr>
<td>Injara</td>
<td>-.135</td>
<td>1.323</td>
</tr>
<tr>
<td>Tawarruq</td>
<td>.299</td>
<td>.241</td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROA

Below are the regression equation values for calculating the dependent variable from the independent variable. The regression model was as follows:

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e \]

\( \alpha \) = constant which is the intercept of the regression equation

\( \beta_1, \beta_2, \beta_3, \beta_4 \) = the gradient which represents the coefficients of the independent variables

X1 – Musharaka
X2 – Mudaraba
X3 – Murabaha
X4 – Injara
X5 – Tawarruq

e = error term which reflects other factors that influence dividend payout ratio

The regression model becomes:

\[ Y = 0.111X1 -0.064X2-0.090X3-0.135X4 -0.299X5 \]
Where \( Y = \text{ROA} \) From the table above the data’s determined regression equation was

\[
\text{ROA} = -1.059 + 0.111\text{Musharaka} - 0.064 \text{Mudaraba} - 0.090 \text{Murabaha} - 0.135 \text{Injara} - 0.299 \text{Tawarruq} + \varepsilon
\]

The regression equation pointed out that bearing Tawarruq, Mudaraba, Musharaka, Injara, Murabaha to a constant zero, performance of SMEs in Nairobi County would be at -1.059, a unit upsurge in Musharaka would bring about an upsurge in financial performance of SMEs by a factors of 0.111, a unit upsurge in Mudaraba would bring about decline in financial performance of SMEs by an aspect of 0.064, a unit upsurge in Murabaha would bring about decline in financial performance by an aspect of 0.090, a unit upsurge in Injara would bring about decline in performance of SMEs by an aspect of 0.135 and a unit upsurge in Tawarruq would bring about upsurge in performance of SMEs by a factor 0.299.

### 4.5 Interpretation of the Findings

The regression equation pointed out that bearing Tawarruq, Mudaraba, Musharaka, Injara, Murabaha to a constant zero, performance of SMEs in Nairobi County would be at -1.059, a unit growth in Musharaka would result in upsurge in financial performance of SMEs by a factor of 0.111, a unit upsurge in Mudaraba would result in decrease in financial performance of SMEs by factors of 0.064.

The analysis indicates that Murabaha and Musharaka are the biggest contributors to the performance of SMEs in Nairobi County. Other financing modes are still lagging behind and despite their growth overtime, their contribution in the portfolio is minimal. A substantial link exists between ROA and different Islamic financing modes. The results of the study also observe that all the determinant variables have an influence on profitability of SMEs by their positive mean values and their standard deviation. Therefore, the different financing modes is essential in profitability of SMEs offering Islamic services.

The results show that the data fits very well into the regression model. The coefficient of determination of 0.651 is indicative of the same. A substantial link exists between Islamic financial services and SMEs performance pointed out by the P (sig) estimate of 0.003 in the
analysis of variances. The P value (sig) also indicates how variations in the predictor's value are linked to variations in the response variable. The results show that any change in any financing mode will have an effect on the ROA.

From the results, there is no indication of multi-Collinearity between different financing modes showing that they don’t relate statistically. This could partly be due to different approach each mode is offering and different Shariah requirements put in place to given each financing mode.

The Pearson correlation for the data points out that a linear association exists between most of the variables of the study. The P value is <0.05 between most variables signifying a powerful link between the variables under study. The strong relationship between Murabaha and the ROA is indicating how any change in murabaha financing affects ROA. Murabaha relates strongly with Musharakawith whereas Mudaraba relates strongly with Tawaruq. This could indicate the specific attributes that this financing modes share despite having being different. The outcomes similarly point out that a negative association exists between Murabaha viz-a-viz Mudaraba and Tawaruq respectively showing the extent of difference between this financing modes.
CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

As per the scrutiny of data obtained the following considerations, inferences and recommendation were established. The answers were grounded on the aim of the investigation which was to verify the effect of Islamic financial products on financial performance of companies of SMEs in Nairobi County.

5.2 Summary
The purpose of the investigation was to determine the effect of Islamic financial products on financial performance of SMEs in Nairobi County. The investigation was undertaken on secondary data of a 5 year period of 2013 to 2017. Regression analysis was performed in analysis of the data.

The study revealed high variation on financial performance due to changes in Islamic financial products like Tawarruq, Mudaraba, Musharaka, Injara, and Murabaha. The investigation pointed out that a powerful association existed between ROA and Islamic financial products and the products variables were significantly influencing ROA among SMEs in Nairobi County. The study also pointed out that positive link existed between ROA and Islamic financial products.

5.3 Conclusion
The results show that SMEs profitability performance is affected by different Islamic financing modes for an Islamic banking portfolio held by any commercial bank. All the financing modes under study are positively correlated to return on income. As per the regression equation it was ascertained that, putting all aspects into the consideration, including different financing modes. Standardized Beta Coefficients determines the influence of every model’s variable. A great value points out that a unit variation in this predictor variable bears a great influence on the standard variable.

The t and Sig (p) values points out a rough suggestion of the influence of every predictor variable – a great total t value and lesser P value points out that a predictor variable is bearing a great influence on the standard variable. From table 4.5, it is clearly evident that the different
Islamic financing modes have a significant effect on profitability given a P value of most of them is <0.05. In general, this study concludes that firms with effective Islamic financing models likely to have higher performance.

Further conclusions were that a unit upsurge in Islamic financial products will cause an upsurge in ROA, a unit upsurge in Tawarruq will bring about a decline in financial performance, a unit upsurge in Mudaraba will bring about an upsurge in financial performance, a unit upsurge in Musharaka will bring about an upsurge in financial performance.

5.4 Recommendations for Policy
The investigation verified that substantial link exists between the different financing modes and return on assets. Therefore, each SME always evaluate its Islamic financing modes availability, uptake and contribution to its profits. All Islamic banks channel their loans through any of the modes under study and this underpins the significance of the different modes to profitability of SMEs. Some financing modes have never been offered or practised in Kenya. These include Salam Bai bi-thamin ajil and Istisnaa. Sukuk was only offered once (2008). There is a need for commercial banks to consider introduction this financing modes to avail customer’s variety in choosing financing modes for their facilities. The Central Bank of Kenya (CBK) should consider putting regulations in place in consultation with different Shariah and Islamic banking practitioners that will enable issuance of Sukus and trading in Kenya.

5.5 Limitations of the Study
Some banks only offer Murabaha as an Islamic financing mode which indicates preference for some modes hence affected the analysis. A number of commercial banks operating Islamic banking windows are yet to do segmental reporting for Islamic banking portfolio therefore rendering data unavailable for such a window. One of the commercial banks in the population which introduced Islamic banking in 2013 completely refused to share its data per financing mode and performance of its Islamic banking window. This distorts the analysis done due to inadequate data available for Islamic banking.
The investigation was restricted to a five year period of 2013 to 2017; however an extended period of the investigation would have considered periods of several economic implications for instance booms as well as downturns. This could have perhaps provided an extended period of investigation hence providing an extensive aspect to the problem.

5.6 Areas for Further Research

For impending investigations, as time goes by, when Islamic banks plenty for investigation and for extended duration, the same investigation would provide more understanding on the performance of Islamic and contribution of each financing mode and provide solid evidence.

A future study could also consider large samples and carry out performance comparison using a combination of models. Other areas of study would include the concept of PLS in Islamic SMEs, other Islamic financing means not used in Kenya such as Salam Bai bi-thamin ajil and Istisnaa and how to come up with innovative Islamic financing products or modes.
REFERENCES


Brian Kettell (2011), Introduction to Islamic banking and finance, John Wiley & Sons Ltd, West Sussex, United Kingdom.


APPENDICES

Appendix I: List of Banks Providing Islamic Banking Services in Kenya as At 2017

1. Gulf African Bank Limited
2. First Community Bank Limited
3. Barclays Bank of Kenya Limited (La riba)
4. National Bank Limited (National Amanah)
5. Chase Bank Limited (Chase Iman)
6. Standard Chartered Bank Limited (Saadiq)
7. Kenya Commercial Bank Limited
Appendix II: Data Collection Schedule

1. Name of SMEs

2. Year of Establishment

<table>
<thead>
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<th>ISLAMIC CONTRACTS AND FINANCIAL PERFORMANCE</th>
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<td>2013</td>
</tr>
<tr>
<td>--------------------------------------------</td>
</tr>
<tr>
<td>Financial performance in terms of (ROA)</td>
</tr>
<tr>
<td>Amount of Musharaka</td>
</tr>
<tr>
<td>Amount of Mudaraba</td>
</tr>
<tr>
<td>Amount of Murabaha</td>
</tr>
<tr>
<td>Amount of Injara</td>
</tr>
<tr>
<td>Amount of Tawruq</td>
</tr>
<tr>
<td>Total Assets</td>
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<td>Net Income</td>
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## Appendix III: Data

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<tr>
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<th>musharaka</th>
<th>mudaraba</th>
<th>murabaha</th>
<th>injara</th>
<th>tawarruq</th>
<th>ROA</th>
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