

**DETERMINANTS OF FINANCIAL CONSTRAINTS ON SMALL AND
MEDIUM ENTERPRISES IN KISUMU COUNTY-KENYA**

BY

CEPHAS ODHIAMBO KASERA

**RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF
THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF
MASTER OF BUSINESS ADMINISTRATION (MBA) IN FINANCE,
SCHOOL OF BUSINESS UNIVERSITY OF NAIROBI**

NOVEMBER 2013

Declaration

I declare that Research proposal is my work and has not been published elsewhere.

Signature.....*Date*.....

Student: Cephas Odhiambo Kasera

REG. NO D61/74381/2012

This Research study has been submitted for examination with my approval as student supervisor

Signature.....*Date*.....

Supervisor: Nixon Omoro

Lecturer, Department of Finance and Accounting, school of Business University of Nairobi

DEDICATION

This study is dedicated to my parents Mr and Mrs Omedo, my wife Dorine and my daughter Angela who have continuously offered me support both spiritually and materially so that I would be able to accomplish this study. They inspired me through their hard work in their areas of interest.

ABSTRACT

Small and medium enterprises (SMEs) in both developing and developed countries play an important role in the process of industrialization and economic growth. An economic survey of 2007 in Kenya puts the contribution of SMEs to employment at 78%. This figure is bound to increase considering that the government of Kenya is keen on improving the economic and social well being of Kenyans through initiatives such as Youth Enterprises Fund, Women Enterprise Fund and Uwezo Fund which are intended to enable the beneficiaries set up SMEs for income generation. It was therefore critical that a serious study was done on the existing SMEs in Kenya so that the prospective entrepreneurs can find a document that can guide them as they get started in business. The research objective was to establish the determinants of financial constraints of SMEs in Kisumu County. The population of study was the 964 registered SMEs as per the Kenya National Chamber of Commerce and Industry (KNCCI) Kisumu chapter (2013). They were randomly sampled to come up with a representative size that formed the basis of the study. The primary method of collecting data was employed to achieve the objective of study. Data analysis involved organizing, accounting for and explaining the data in terms of the respondents definition of the situation using patterns, themes and categories. The statistical package for social sciences (SPSS) was employed in analyzing data. Majority of respondents revealed that their business faced numerous constraints that hindered growth. Findings of the study revealed that contribution from friends was a major source of financing accounting for 55 % of respondents. 40% of respondents indicated that they depended on loans as a financing source and only 5% depended on personal savings. Majority of respondents indicated that lack of information was a major constraint when sourcing for funds, accounting for 60% of the respondents. 13% of the respondents revealed that lack of collateral was a major constraint and 27% of the respondents indicated that transaction costs were a major constraint. Majority of respondents indicated that the major determinants of financial constraint included: Size of the Firm, Age of the firm, Firm ownership, Professional experience, Level of Education, Business Strategies and Location of the firm. These findings will be useful to policy makers and entrepreneurs in finding ways to address these obstacles.

ACKNOWLEDGEMENT

I wish to register my honest appreciation to my supervisor Mr Nixon Omoro, for having agreed to supervise this research paper and for his guidance through the process of coming up with this document.

I would also like to express my sincere thanks to my teachers for equipping me with the knowledge upon which I was able to carry out this research. My other appreciation goes to my colleagues in college for the encouragement they offered me during my studies. My gratitude extends to my family members especially my wife for giving time off the family issues to concentrate on my studies.

Table of Contents

Declaration.....	ii
DEDICATION.....	iii
ABSTRACT.....	iv
ACKNOWLEDGEMENT.....	v
List of Tables.....	ix
ACCRONYMES AND ABBREVIATIONS.....	x
CHAPTER ONE: INTRODUCTION.....	1
1.1 Background of the Study.....	1
1.1.1 Financial Constraints.....	2
1.1.2 Determinants of Financing Constraints of Small and Medium Enterprises.....	3
1.1.3 Small and Medium Enterprises.....	4
1.1.4 Small and Medium Enterprises Financial Constraints.....	5
1.1.5 Small and Medium Enterprises in Kisumu County.....	7
1.2 Research Problem.....	7
1.3 Research Objective.....	9
1.4 Value of the Study.....	9
CHAPTER TWO: LITERATURE REVIEW.....	10
2.1 Introduction.....	10
2.2 Theories Underpinning the Research Study.....	10
2.3 Determinants of Financial Constraints.....	11
2.4 Empirical Study.....	22
CHAPTER THREE: RESEARCH METHODOLOGY.....	31
3.1 Introduction.....	31
3.2 Research Design.....	31

3.3 Study Population.....	31
3.4 Sample Size.....	31
3.5 Data Collection	32
3.6 Data Analysis.....	32
CHAPTER FOUR: DATA ANALYSIS RESULTS AND DISUSSIONS	33
4.1 Introduction.....	33
4.2 General Information.....	33
4.2.1 Gender of respondents	33
4.2.2 Level of Education of respondents.....	34
4.2.3 Duration in Business	35
4.2.4 Start up Capital	36
4.2.4 Number of Employees Business	37
4.3 Source of Financing	38
4.6 Difficulty in sourcing of Funds.....	39
4.7 Determinants of financial constraints	40
4.7.1 Size of the Firm.....	40
4.7.2 Age of the Firm.....	41
4.7.3 Firm Ownership	42
4.7.4 Professional Experience.....	43
4.7.5 Level of Education.....	44
4.7.6 Strategies and networking.....	44
4.8 Descriptive Statistics.....	45
4.7 Discussion.....	46

CHAPTER FIVE: SUMMARY	49
5.1 Introduction.....	49
5.2 Summary	49
5.3 Conclusion	49
REFERENCES	52
APPENDIX - Questionnaire	52

List of Tables

Table 4.1- Gender of the respondents

Table 4.2- Level of Education of respondents

Table 4.3 - Duration in Business

Table 4.4 -Start up Capital

Table 4.5 -Number of employees

Table 4.6 -Source Financing

Table 4.7- Difficult in sourcing Finances

Table 4.8 - Size of the Firm

Table 4.9 -Age of the Firm

Table 4.10 -Firm ownership

Table 4.11-Professional Experience

Table 4.12 -Level of Education

Table 4.13 -Strategies and networking

Table 4.14 Descriptive Statistics

ACCRONYMES AND ABBREVIATIONS

EAC	East Africa Community
GOK	Government of Kenya
IADB	Inter-American Development Bank
KNCCI	Kenya National Chamber of Commerce and Industry
SME	Small and Medium Enterprises

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Small and medium enterprises (SMEs) in both developing and developed countries play an important role in the process of industrialization and economic growth, by significantly contributing to employment creation, income generation and catalyzing development in urban and rural areas. The economy of many countries is therefore dependent on the SMEs which are run by the middle income entrepreneurs.

Small and medium enterprises in Kenya's manufacturing sector are defined as enterprises with fulltime employees not exceeding 100 or having annual sales turnover not exceeding Ksh 150 million. The growth and development of small and medium enterprises forms an integral component of Kenya's initiative to be globally competitive and prosperous nation with high quality of life by 2030 (GoK, 2007).

While many country level and microeconomic studies have assessed the importance of SMEs in the economic development and industrialization process (Snodgrass and Biggs, 1996) and Beck et al. (2005) provide the first cross-country evidence on the links between SMEs, economic growth, and poverty alleviation. SMEs form a large part of private sector in many developed and developing countries.

Other research findings have found that there is a link between SMEs and economic development in many countries, there still lays substantial evidence that small firms face larger growth constraints and have less access to formal sources of external finance (Elsevier, 2006). Financial institutions have tried to help alleviate SMEs growth constraints by increasing their access to external finance and leveling the field between

firms of different sizes but still a lot of SMEs remain underfunded. This calls for further research on why this problem persists despite these efforts by the financial institutions.

Business environment and growth efforts targeted at the SME sector are often based on the premise that SMEs are the engines of growth, but market imperfections and institutional weaknesses impede their growth. Skeptics question the efficacy of this policy and point to empirical evidence either in favor of large firms or of a size blind policy approach (Biggs, 2002). This study looks at the operations of SMEs, the gaps that are left by the financial institution in trying to fund the SMEs and other constraints that may impede the growth of SMEs.

There has however been a challenge to SMEs that operate in Kenya due to constraints in accessing funds that can enable them expand their businesses and thus achieve growth. These constraints have seen many enterprises dwindle in their operations and even close shop because of being unable to compete with more stable firms which are given preference by financial institutions when it comes to funding.

1.1.1 Financial Constraints

Over the years, a number of theories have attempted to explain the constraints that Small and Medium Enterprises have faced in their efforts to achieve growth. Access to finance is rated as major constraint by around 30% of small and medium enterprises, a similar proportion as economic policy uncertainty and corruption. Further, financing is one of the few characteristics of the business environment that together with crime and political instability is robustly linked to firm growth (Beck and Demirgüç-Kunt (2006). while other features have at most an indirect effect on firm growth (Ayyagari, Demirgüç-Kunt and Maksimovic, 2006). Small firms consistently report higher financing obstacles than

medium and large enterprises. Smaller, younger and domestic (as opposed to foreign-owned) enterprises report higher financing obstacles even after controlling for other firm characteristics. The relationship is not only statistically but also economically significant.

The probability that a small firm lists financing as a major obstacle to its growth is higher than that of a big firm (Beck, Demirgüç-Kunt, Laeven and Maksimovic, 2006). SMEs' financing constraints include the access to and the cost of finance. The difference between small and large firms is at least as big or even bigger for some of the specific financing obstacles, such as collateral requirements, bank paperwork, interest rate payments, the need for special connections and banks' lack of lending resources. Also the lack of access to specific forms of financing such as export, leasing and long-term finance is significantly more constraining for small firms' growth than for large firms' growth (Beck et al. 2005).

1.1.2 Determinants of Financing Constraints of Small and Medium Enterprises

Lou and Beamish (2006) investigated the link between growth and financing using a sample of 164 Japanese SMEs and established that growth is measured by sales growth and asset growth. The "idle capacity" interpretation of firm growth has been linked to expectations that younger enterprises would be under a particularly strong incentive to pursue growth. Two alternative lines of argument have been proposed as to why this should be so (Moreno and Casillas, 2007). The first is the "theory of learning" interpretation: younger enterprises tend to have higher growth rates than older enterprises

because they have less understanding of the costs related to their activities and of how these costs vary over time. The insight of longer established firms into the links between enterprise size and efficiency, on the other hand, is well developed and acts against the pursuit of growth. A similar argument is that new enterprises are characterized by a “liability of newness” because they have fewer opportunities to experiment with different resource combinations. In contrast, an entrepreneurial model of enterprise growth argues that young firms are more innovative, proactive and risk oriented than older firms; some emerge specifically to take advantage of a new opportunity.

1.1.3 Small and Medium Enterprises

The term “SME” encompasses a broad spectrum of definitions. Different organizations and countries set their own guidelines for defining SMEs, often based on headcount, sales or assets. Dalberg Global Development Advisors survey report of 2011 came up with varied definitions of SMEs in different countries. Egypt defines SMEs as having more than 5 and fewer than 50 employees, Vietnam considers SMEs to have between 10 and 300 employees. The World Bank defines SMEs as those enterprises with a maximum of 300 employees, \$15 million in annual revenue, and \$15 million in assets. The Inter-American Development Bank, meanwhile, describes SMEs as having a maximum of 100 employees and less than \$3 million. The European Union definition: ‘The category of micro, small and medium-sized enterprises is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.’ Small and

medium enterprises are thus defined as firms with 10 to 250 employees as and more than 10 million euro turnover or annual balance sheet total of not more than 43 million Euros. This definition is more encompassing, and much larger, especially with regards to turnover, than some other.

Small and Medium Enterprises can be generally described as business entities which operate at a small scale to medium size levels. SMEs form the bulk of entrepreneurs in most developed and developing countries and as such can be used to spur economic growth and development in many countries if well funded and managed. Developing countries like Kenya have seen a phenomenal increase in SMEs operating within its borders due to the need by the population to create wealth and have a source of livelihood.

1.1.4 Small and Medium Enterprises Financial Constraints

Small and Medium-sized Enterprises are the main players in developing and strengthening zonal integration. A sample survey of 1933 firms located within 5 East African countries with economic integration known as East Africa Community (EAC) found out that financing constraints in East African firms are broadly based across firms but SMEs are mostly affected. Globally SME sector has been reporting difficulties in access to finance (Bebczuk, 2004; Slotty, 2009; Balling et al., 2009; Irwing & Scott, 2010; Yongqian et al., 2012). Access to external finance by SMEs has become more costly and troublesome while their accessibility has sharply declined.

SMEs' financing constraints limit their investment opportunities and stagnate growth. Access to finance is widely perceived to be an essential factor for firms, and especially SMEs, to maintain their daily business operation as well as to achieve long-term investment opportunities and development targets. Presence of general limitations on access to capital markets has seen many East African firms heavily rely on the banking sector for credit. Therefore, a well-functioning banking sector plays an important role in channeling resources to the best firms and investment ventures.

Financing constraints crucially limit firm's growth, availability of productive resources resulting in sluggishness of the sector which might pose threat to the sector's contribution to the economy. Recently SMEs financing has raised interest in policymakers, researchers and practitioners as an agenda of interest on how to encounter the problem. SMEs are thought to have a financial growth cycle in which financial needs options change as the business grows, gains further experience, and become less informational opaque. Initial financing for SMEs include funds provided by the owner(s), family members and friends prior to and at the time of the firm's commencement of operation. As firms grow, they gain access to intermediate finance on the equity side and on the debt side (banks, finance companies, etc.). In the long run, if the firm remain in operation and continue to grow, it might gain access to debt markets and stock market. Firm's growth cycle model might not become applicable to all small businesses since firm size, age, and information availability are far from perfectly correlated.

1.1.5 Small and Medium Enterprises in Kisumu County

Kisumu County is generally an agricultural place and farmers in this area grow such crops like maize, sugarcane, rice and other food crops for subsistence. The county is also endowed with fishing activities which go on in the lake situated in its borders. These activities form the backbone of economic stay of the people living in this county.

Kisumu County has an estimated population of 970,000 people (2009 census).

A third of this population lives in Kisumu town which forms the county headquarters and this is where most the SMEs are concentrated. The focus of the study was therefore in Kisumu town and other smaller towns like Ahero, Maseno, Awasi, Katito, Muhoroni and other trading centres located within the county. The SMEs operating in all these towns were sampled to come up with representative information regarding their operational constraints.

1.2 Research Problem

Small and medium enterprises play a major contribution to employment and income generation in many developing countries like Kenya. An economic survey of 2007 in Kenya puts the contribution of SMEs to employment at 78%. This figure is bound to increase considering that the government of Kenya is keen on improving the economic and social well being of Kenyans through initiatives such as Youth Enterprises Fund, Women Enterprise Fund and the latest one Uwezo Fund which are intended to enable the beneficiaries set up SMEs for income generation. It is therefore critical that a serious

study is done on the existing SMEs in Kenya so that the prospective entrepreneurs can find a document that can guide them as they get started in business.

Aaker (1992) in his study specify that drafting a strategy, defining how the firm chooses to compete, obtaining a sustained competitive advantage valued by the organization client base, and supported by skills and resources, will be the most relevant key to success and growth in the future. Other researchers like Veciana (1999) affirms that focusing on the firm's internal competencies and strategic content has been found to be and will remain a priority for businesses desiring to gain and hold an advantage over competitors.

Kakuru (2008) examined how supply-demand factors interface with credit flow to small and micro enterprises in Uganda. He looked at the experiences of people who are at the centre of making lending and borrowing decisions and who have a major influence on credit availability to the SME sector. Kira (2013) looked at the Determinants of Financing Constraints in East African countries' SMEs and observed that local privately owned firms report higher financing obstacles than firms that are privately foreign owned. Wanjau, et al (2007) examined the role of quality in growth of Small and Medium Enterprises and economic development in Kenya. However, having looked at the above studies it is evident that not much has been researched on the influence of financial constraints on the SMEs especially in Kenya. This has informed my study to fill the gap on why most SMEs perform dismally and end up closing down after a few months or years of operation in Kisumu.

This research study seeks to answer the following question: What are the determinants of financial constraints in SMEs?

1.3 Research Objective

The research objective was to establish the determinants of financial constraints on SMEs in Kisumu County.

1.4 Value of the Study

The study will benefit Researchers, Academicians and Students especially those who will want to carry out a similar study in the future. The researcher benefited from the research study by getting an understanding of the macroeconomic factors that impact on SMEs regarding their funding as they try to access finances to achieve growth. The SMEs themselves will benefit from the study by making informed decisions based on the findings of the study so that they can find a way of alleviating the constraints. The investors will benefit by knowing where to channel their funds based on prospects of positive returns. They will analyze the experiences of financial institutions and the SMEs to determine whether to advance credit facilities to these enterprises and also generate strategic responses to the prospective entrepreneurs who may seek funds for investment.

The study looks at the cost of obtaining funds from the various financing options like the use debt and equity by assessing their advantages and disadvantages to the prospective entrepreneurs. The study also looks at the requirements that are obtaining to a SMEs growth and the risks that firms are likely to encounter in their endeavor to achieve growth. The study will be used by practitioners of management to analyze the growth patterns of SMEs vis -avis their accessibility to finances and the management of these finances.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter looks at both the theoretical and empirical framework of the research study. It gives an overview of theories and evidence of financial constraints, theories of SMEs financing, determinants of the funding and empirical studies

2.2 Theories Underpinning the Research Study

A number of theories and empirical studies have been advanced to explain the growth of SMEs. Some of these theories include:-The pecking order theory, the growth cycle theory and tradeoff theory.

The pecking order theory relates to how firms evaluate the source of finance when they want to borrow funds for investment. The order starts from less costly source of finance to the most costly source (Myers, 1984). Capital structure has proved to be a perennial puzzle in finance. The original M and M propositions (Modigliani and Miller, 1958 and 1963) highlighted the important issues involved in financial structure decisions namely: the cheaper cost of debt compared to equity; the increase in risk and in the cost of equity as debt increases; and the benefit of the tax deductibility of debt.

They argued that, in the absence of taxes, the cost of capital remained constant as the benefits of using cheaper debt were exactly offset by the increase in the cost of equity due to increased risk. With taxes and the deductibility of interest charges they concluded that

firms should use as much debt as possible. Trade off theory identifies the optimal debt-to-equity ratio as the level at which the two offset each other (Brealey and Myers, 1991). Modigliani and Miller have famously demonstrated how, under a very specific set of assumptions, the capital structure of the firm does not affect its value. This finding has been subsequently overturned due to the unrealistic nature of its assumptions, such as the absence of taxes, risk, bankruptcy costs, asset characteristics and asymmetric information. The trade off theory avers that debt is typically cheaper for a firm to service because it does not imply any form of risk-sharing and it can be collateralized, unlike equity that has a residual claim. In this sense, a firm can lower its weighted average cost of capital, at least initially, through leverage. Leveraging, however, also increases the financial risk of the firm that must service its debt regularly, unlike its equity. In this sense, a firm must balance the benefit brought about by the lower average cost of capital against the increase in financial risk.

2.3 Determinants of Financial Constraints

Access to finance and the cost of finance is often ranked as one of most constraining features of the business environment by SMEs. Specifically, the cost of finance is rated by over 35% of small and medium enterprises as major growth constraint in a sample of 71, mostly in developing countries, more than any other characteristic of the business environment. Others characteristics including tax rates and macroeconomic instability, are also rated by many SMEs as major growth constraints (Beck and Demirgüç-Kunt (2006). Access to finance is rated as major constraint by around 30% of small and

medium enterprises, a similar proportion as economic policy uncertainty and corruption. Access to finances is directly linked to firm growth, while other features have at most an indirect effect on firm growth (Ayyagari, Demirgüç-Kunt and Maksimovic, 2006).

Small firms consistently report higher financing obstacles than medium and large enterprises (Beck, Demirgüç-Kunt, Laeven and Maksimovic, 2006). Smaller, younger and domestic as opposed to foreign-owned enterprises report higher financing obstacles even after overcoming other firm characteristics. The relationship is not only significant statistically but also economically.

The probability that a small firm lists financing as a major obstacle (as opposed to moderate, minor or no obstacle) is 39% compared to 36% for medium-size firms and 32% for large firms. The higher financing obstacles reported by small as compared to large firms are also reflected in financing patterns. While small firms finance less than ten percent of their investment needs with bank finance, large firms finance more than 20% with bank credit. Large firms have a similar, though not as strong, advantage, in trade credit and development finance, while small firms seem to finance a larger part of their investment with equity and informal finance, compared to large firms (Beck, Demirgüç-Kunt and Maksimovic, 2005). Researchers have come up with theories on the financing of SMEs. Some of the theories that have been explored include the pecking order theory and the tradeoff theory.

Several evidences have been aduced as to the determinants of funding for the SMEs. Among these is firm size which determines how much finance a firm is able to access

(Beck et al, 2005). Firm size plays a critical role in determining its financing obstacles. Older and larger firms tend to have lower financing obstacles compared to new and relatively smaller firms. This phenomenon is attributed to transaction cost and information asymmetries. Small firms are relatively more opaque and less to offer as collateral compared to large firms and thus face higher risk premiums. Age and technology indicate the level of efficiency in a firm being able to utilize the funds advanced to it (T.Beck-Int.Money Fin, 2007). Firms which have matured in their operations and advanced in technology tend to have easy time accessing finances compared to new firms which are just venturing the market.

Financial institutions would assess the operation of firms in terms of performance by looking at their books of accounts for a certain period of time before they make a decision on whether to offer a credit facility. The use of technology to reduce cases of inefficiency also forms a major determinant of lenders to finance activities of particular firms. Another argument is that new enterprises are characterized by a “liability of newness” because they have fewer opportunities to experiment with different resource combinations. Ownership of the firm is also cited as one the determinants of funding for SMEs. Hall & Hutchinson (2004) argue that a firm’s ownership which measures its ability to access credit is determined by the capital structure of the firm. The capital structure reveals the level of leverage of a firm and this has a direct effect on the firm’s borrowing ability. Ownership may also refer to whether a firm is individually owned or a partnership or a corporation which is public limited company. Public limited companies operate on a larger scale than partnership and sole proprietorship. As such they have a

larger asset base than the other two forms of ownership and can offer better collateral to secure credit than their counterparts. Firms in countries with more effective and more adaptable legal systems report lower financing obstacles (Beck et al., 2005) and the effect of financial and legal obstacles on growth is lower in countries with better developed legal systems, especially for small firms. A rapidly expanding literature has shown the positive effect that credit information sharing has on the credit availability to SMEs (Miller,2003). Since the mid-1990s, the use of information from bureaus and other proprietary information from financial institutions for small business credit scoring has become popular in the US and other developed economies. This technique relies mostly on information on the owner rather than the small firm itself and can significantly reduce transaction costs of loan processing. Frame et al. (2001) show that the use of credit-scoring techniques has increased small business lending by banks in the US. Depending on the legal and information environment in their respective country, financial institutions around the world have developed specific techniques to lend to small, opaque firms with little or no collateral. Lending decisions based on soft information and long term relationships between lender and borrower has long been seen as the major lending technology benefiting SMEs.

The characteristics of owners and managers which include their age, education, professional experience, management skills, etc., have been consistently proposed to influence firms' access to credit. Concerning educational background, Kasseeah & Thoplan (2012) suggested that the level of education of owner, which is measured by primary, secondary and tertiary education, do contribute positively to the performance of

SMEs. SMEs with more highly educated owners seem to perform better even after controlling for age, experience and employment level. Higher education brings business owners to a better position to understand the requirements for operating a business and may help them manage various aspects of the business. Education together with experience also equips managers to better prepare and present a loan application in the form that a lender wants to see (Coleman, 2004).

Empirically, in a study of 4400 small firms, Bates (1990) found that owners with four or five years of college or university education could have access to bank capital more easily but there was no evidence that high education level improve access to non-bank capital. The impact of education on access to finance for SMEs in Viet Nam, however, seems very mixed. On the one hand, Thanh et al. (2011) found that firm owner's experience significantly reduce the probability of bank loan being rejected. On the other hand, Venkatesh, et al (2006) argued that owner's education is negatively correlated with bank loan. According to Rand (2007), there are likely negative correlations between being high or medium skilled and accessing credit, reflecting that owners with higher skill levels have lower demand for debts and finance themselves by internal funds or that better educated and experienced owner are more likely to know when their application will be rejected and therefore refrain from applying. In terms of gender, Baydas, et al (1995) and Tsai(2004) both suggested that less educated and "finance literate" women participate more in the informal financial transactions compared to men. In contrast, Yaldiz (2011), argued that to establish and conduct a business in men's world, business women can be considered as better educated, more talented compared to

other business men. As a result, he empirically proved that women are likely to have more ability to access formal credit. Regarding to owner's age, Yaldiz et,al(2010) proposed the positive correlation between owner's age and working experience, which likely helps reduce the firm's financing obstacles. However, Nakano & Nguyen (2011) argued that the older the entrepreneurs get the more risk-averse and less energetic at work they are. As a result, they seem to prefer use of more formally external loans or their own asset rather than approaching informal debts. In brief, owner's characteristics might have very mixed impact on accessibility of formal and/or informal capital and the result seems to vary across countries.

Various researches have also pointed out that credit accessibility varies among firms according to firm specific characteristic, and its characteristic, in return, determines the best suited way for firms to approach credit. In particular, size of firms which is one of the most reliable predictor of firms' financing obstacles also explains the firms' different fund choices ((Beck, 2007; Beck, Demirgüç-Kunt, Laeven, & Maksimovic, 2006; Bernanke, Gertler, & Gilchrist, 1994; Devereux & Schiantarelli, 1990). Beck and Levine (2004) suggested that small firms have to finance a larger share of investment with informal sources, such as moneylenders or family and friends or heavily depend on short-term bank loans; whereas larger firms facilitate their investment by a greater share of formal external sources like equity and bank finance. Technically, this finding matches the theoretical models that used fixed transaction costs and information asymmetries and the resulting agency problems as basis for financial market frictions. Economically, large firms, which face less constraint in credit, are likely to access many alternative fund

sources. In the meanwhile, small firms with their small size give a signal of relatively higher credit risk so that the banks, which are risk-averse, has less incentive to lend them money (Black, 2012). As a result, they are likely to depend more on informal sources.

While firm size used to be measured by the number of employees and the annual turnover thresholds (EC, 2005), Coleman's report (2002) also suggests that a firm's profit could be introduced as a useful proxy.

Age of a firm has also been reported to determine the choice of credit finance in many studies. Gertler (1988) stated that information asymmetries are likely to be especially large for young and newly-established firms, because creditors have not had enough time to monitor such firms and because such firms have not had enough time to build long-term relationships with suppliers of finance. As a result, young enterprises, especially the start-ups, are likely to seek finance from informal sources, whereas the older have more advantage in searching for bank debts or equity. This result was also empirically proved by many authors, such as Akoten, et al.,(2006), Oliner & Rudebusch(1992) and Beck, et al., (2006). However, Rand (2007) found a negative relation between age and holding debts. His argument was that old firms are often more settled and less likely to engage in activities that are risky and requiring a huge amount of capital investment, so they may seek less formal sources of credit. Besides, with the support from pecking order theory proposed by Myers (1984), old firms are more likely to finance themselves through their internal credit (Le, 2012). Last but not least, it is also claimed that in less developed countries where institutional system is not well-developed, collateral and guarantees, which are represented by the ratio of tangible asset in total asset, remain one of the main

factors leading to banks' lending decision (Uchida, 2011). While Viet Nam's institutional system is far from developed, the bank system is less competitive and possession of property rights still have a large positive impact on ease of credit, firms that lack collateral assets account for a major proportion of rejected loan requesters (Thanh et al., 2011). Beck (2007) noted that there is a broad variation of firms' financing obstacles among countries after controlling for cross-country difference in GDP per capita, suggesting that geography or, more specifically, firms' location is likely to involve in credit constraint, and therefore is an explanatory factor for firms' credit determination. Yaldiz (2011) empirically showed that firms located in smaller cities rely more on informal credit compared to firms in bigger cities. Gine (2011) documented the transaction cost to evaluate the creditworthiness of a firm which is likely high in rural areas, hence banks are less willing to lend firms in the rural or long-distance areas. On the other hand, firms located in the urban areas or near a commercial bank may access bank loans likely more easily since it is convenient for a bank to monitor and obtain "soft" information that allow it to give a decision on loan requests (Petersen & Rajan, 2002)

Literature has also revealed the diverse financing pattern across firm categories. Generally speaking, government-owned firms, which suffer less financing obstacles than others, can access have to formal debts more easily since they receive direct budgetary support from the government and favorable treatment from government-owned financial institutions (Harrison, Love, & McMillan, 2004; Laeven, 2003). Networking also seems to have a great voice over financing pattern of SMEs, particularly in developing countries where financial system is under-developed. According to Shane & Cable (2002),

networks can be used to reduce information asymmetry in creditor/debtor relationship. To a larger extent, networking and relationships substitute for the lack of effective market institution, and can be an effective way for firms to access external credit, including bank loans. Networks and relationships increase a firm's legitimacy, which in turn positively influence the firm's access to credit. In addition, Safavian & Wimpey (2007) and Straub (2005) agreed that networks are also important for firms which largely rely on informal sources of credit. Lenders rely primarily on "soft" information gathered through contact over time with the SME, observing its profitability performance and previous loan payments history to judge the creditworthiness of the firms and to price the loans. This result is consistent with Rand (2007) finding that firms which have borrowed from the creditor before and have built up some kind of business relationship are faced with significantly lower cost of capitals. Further, Bougheas, et al.,(2006) suggested that network is a dominant determinant that helps firms to be less financially constrained, since relationships with the lenders makes a firm easier to access credit, even when it is weak on other criteria. In the case of Viet Nam, Le & Nguyen (2009) found that official network, the relationship with government officials or bankers, are significantly and positively associated with the possibility of acquiring bank loans; however, it doesn't have enough power to influence the actual amount of bank lending. In another approach, Le et al.,(2006) also added that networking for firms in the first stage more effectively help them access credit than that of later growth stage firms. They argued that through networking, especially with government officials, firm legitimacy increases in the eye of aid donors and government support programs, hence raising the accessibility to the less expensive sources of financing. On the other hand, they also suggested that social

networks, especially network with members of social organization or clubs, significantly increase the ability of approaching informal credits. Malesky & Taussig (2009) further added that bank credit accessibility is likely easier for Viet Nam's rural companies, but more difficult to firms in more competitive and better governed urban environments. They explained that the result comes from the fact that Viet Nam state-owned commercial banks' lending purpose is in favor of rural enterprises to improve national welfare.

Firm-level productivity is hypothesized to improve both the chance of SMEs participation and performance, in production networks. This hypothesis draws from the most recent findings from research on firm exporting behavior, which finds that exporters are more productive than non-exporters. The superior productivity of exporters is due to what the so-called 'selection hypothesis', which argues that only the most productive firms are able to survive in the highly competitive export markets. The hypothesis is based on the presumption that there are additional costs involved in participating in export markets. These costs, which usually involve high fixed costs, include transport costs and expenses related to establishing distributional channels, and as well as production costs in adapting products for foreign tastes (Bernard and Jensen, 1999). Even when a firm has managed to grow from non-exporter to become an exporter, productivity still matter for the exporter's overall performance. This comes from learning from what the so-called 'learning-by-exporting hypothesis', which argues that there is a learning effect from participating in exporting activities which will result in productivity improvement. (Harvie and Sothea, 2010)

SMEs tend to suffer from many competitiveness issues, compared to larger firms. The fact that most end products produced by networks of production are exported final goods, it is sensible to argue that SMEs wanting to participate in production networks need to adopt the characteristics of exporters in general. The literature briefly reviewed above suggests that productivity matters in determining a firm's ability to serve export markets. In the context of SMEs and production networks, an important aspect of this may be reflected in the ability of SMEs to meet the strict requirements of the higher and larger firms in networks of production. The reasoning above also justifies the hypothesis that productivity is not only expected to improve the likelihood that SMEs will participate in production networks, but also to improve the SMEs' performance once they are already in the networks, and/or exporting at the same time. SMEs with better access to finance are hypothesized to have a higher probability of engaging and performing well in production networks. The potential for credit rationing defined as the degree to which credit or loans are rationed, as the impact of an imperfection in the capital market (Stiglitz and Weiss, 1981) is thought to be higher for smaller firms. Petersen and Rajan (1994) argue that the amount of information that banks could acquire is usually much less in the case of small firms, because banks have little information about these firms' managerial capabilities and investment opportunities. The extent of credit rationing to small firms may also occur simply because they are not usually well collateralized (Gertler and Gilchrist, 1994).

Harvie, et, al (2010) assert that the ability of a firm to get a loan depends on how well the firm is able to service the debt. This in turn, depends on the net worth of the firm, such

as the value of cash inflow and the liquid assets that the firm is able to generate. Lower net worth implies lower ability to service debt and hence it reduces the chance of a firm getting a loan or a higher amount of credit. Banks, or any other lending institutions, are likely to attach a high-risk premium to a firm with a low net worth position. SMEs that participate in production networks have the probability of better cash flows than those that do not. SMEs in production networks have more certainty in terms of their production, since most of the time they operate based on larger, stable and more certain buying orders from other firms in the networks. More formal and modern managerial practice by firms operating in production networks, in addition to the likelihood of more interactions with banks, also helps SMEs that operate in production networks to gain more trust from banks or other formal financial institutions. All these, which are commonly said to form the ‘balance sheet channel’ in financial economics literature, suggest that highly leveraged SMEs are expected to have lower probabilities of engaging and performing well in production.

2.4 Empirical Studies

Koehn (2011) finds that the factors that contribute to a firm’s growth are sales, workforce, business size and product line. She established that the factors that influence growth are capital market, cost, capital access, collateral requirement and access to information. There is no single strategy that can be associated with growth of SMEs. The best performing SMEs however, are those that are active along a number of dimensions while being particularly active in managing their products and markets (Wanjau et

al.,2007). They find that there is a direct relationship between quality practices and organizational growth.

Klapper et al. (2006) show that one channel through which the business environment affects economic development is the entry of new firms. Using firm-level data for Western and Eastern Europe, they find that entry regulations, measured as the cost of registering a firm, hamper the creation of new firms, while regulations fostering property right protection and access to finance enhance entry. Firms are not only more likely to enter in countries with better access to external finance and better investor protection, they are also more likely to incorporate than to maintain the legal form of proprietorships (Demirguc-Kunt et al., 2006). Using firm-level survey data for 52 countries, Demirguc-Kunt et al. show that one of the reasons for this variation in the likelihood of incorporating is the fact that incorporated firms face lower obstacles to their growth in countries with better developed financial sectors and efficient legal systems, strong shareholder and creditor rights, low regulatory burdens and corporate taxes and efficient bankruptcy processes.

Using firm level survey data on the business environment across 80 countries, Ayyagari et al., (2005) investigate the impact of access to finance, property right protection, provision of infrastructure, inefficient regulation and taxation, and broader governance features such as corruption, macroeconomic and political stability on firm growth. They found that corporations report fewer financing, legal and regulatory obstacles than unincorporated firms and this advantage is greater in countries with more developed

institutions and favorable business environments. Further, they find some evidence of higher growth of incorporated businesses in countries with good financial and legal institutions. They show that finance, crime and political instability are the only obstacles that have a direct impact on firm growth and finance is the most robust one amongst others.

Biggs and Shah (2006) find that Indian entrepreneurs in East Africa, Lebanese firms in West Africa and European enterprises in Southern Africa form business networks whose members lend to each other, provide personal references and ease transactions with an informal contract enforcement system based on reputation. These networks help overcome the problems of asymmetric information and weak formal contract enforcement systems. Advantages of networks even extend to new entrants who start out twice as large in terms of assets as new entrants outside the ethnic networks and get immediate access to supplier credit without having to build up a reputation and relationships. Beck et al. (2005) shows that size, age and ownership are the most reliable predictors of firms' financing obstacles. The authors find that older, larger and foreign-owned firms report lower financing obstacles. The relationship is not only statistically but also economically significant. The probability that a small firm lists financing as a major obstacle as opposed to moderate, minor or no obstacle is 39% compared to 36% for medium-size firms and 32% for large firms.

The higher financing obstacles that small firms report match not only anecdotal evidence from both developed and developing countries; they also confirm theory's predictions. In

a world with fixed transaction costs and information asymmetries, small firms with demand for smaller loans face higher transaction costs and face higher risk premiums since they are typically more opaque and have less collateral to offer (Beck et al., 2004). While there are no significant differences in the case of lease finance, larger firms finance a greater share of investment with equity and perhaps surprisingly with development finance than small firms. On the other hand, smaller firms finance a larger share of investment with informal sources of finance, such as moneylenders or family and friends (Beck et al. 2005). He shows that institutional development, broadly defined, is the most significant country characteristic that can explain cross-country variation in firms' financing obstacles, even after controlling for cross-country income per capita variation.

Credit availability to enterprises, but especially to SMEs, depends on the infrastructure that supports financial transactions, including the legal system and the information environment. Commercial laws that effectively assign and protect property rights and their efficient enforcement are crucial for financial transactions. This includes the laws, regulations and institutions to create, register and enforce collateral and an effective bankruptcy system. Firms in countries with more effective and more adaptable legal systems report lower financing obstacles and the effect of financial and legal obstacles on growth is lower in countries with better developed legal systems, especially for small firms (Beck et al. 2005).

Beck (2007) argues that the availability of finance to new SMEs can be influenced by both borrower-specific (internal factors) and systemic factors (external factors).

Atieno (2009) points out that by utilizing network relationships as an entrepreneurial strategy, a new SME can obtain access to vital resources, capabilities and information resulting in entrepreneurial opportunity. Furthermore, the scope for optimization that the lender will have in managing lending costs and risks can also be constrained by external or systemic factors (also known as state variables), such as the contractual and informational frameworks, macro-economic environment, social factors (crime, corruption and ethics), technology, the regulatory environment and other characteristics of the business environment in which both the lender and borrower operate. These state variables are not only outside the reach of lenders' actions, but neither can policy makers change them in the short-run. Fatoki and Smit (2010) study compared the constraints to credit access from both commercial banks and trade creditors. The similarities and differences in the constraints to credit access from commercial banks and trade creditors will be explored. Lepoutre and Heene (2006) find that small firms experience more difficulties than their larger counterparts when engaging in ethically responsible behaviour. The single most unethical practice by small firm professionals is dishonesty in making and keeping contracts. Hannafey (2003) points out that new SMEs face significant resource pressure. Thus, liability of newness may lead new SMEs towards more individualist ethical postures. Investors risk perception may be influenced by the extent to which they perceive that they can trust the entrepreneur or entrepreneurial team. The Organisation for Economic Co-operation and Development (2006) shows that market imperfections such as those caused by inefficient legal systems can constrain the ability of firms to access external finance. Firms in countries with more efficient legal systems should therefore obtain more external financing than firms in countries with less efficient

legal systems. The World Bank (2003) reveals a relatively inefficient legal system in South Africa compared to developed countries. There is a shortage of judges and magistrates, backlog of cases and lower creditor protection in practice. Crime and corruption in South Africa are high and widely believed to restrain investment. The World Bank (2008) finds that 30% of enterprises in South Africa identify rate crime as a major or very severe constraint on investment, putting crime amongst the four most frequently mentioned constraints. The rate of corruption in South Africa is relatively high compared to developed countries (Transparency International, 2008).

A thorough review of the literature on SME financing shows that no study in South Africa has investigated empirically how the business environment constraints credit access to new SMEs from the supply-side.

The theoretical principles underlying capital structure can generally be described in terms of the static trade-off theory by Modigliani and Miller (1958, 1963), the agency theory by Jensen and Meckling (1976) and the pecking order theory by Myers (1984). According to Andree and Kallberg (2008) the genesis of modern capital structure theory lies in the work of Modigliani and Miller (1958) in their famous proposition I – often referred to as the “irrelevance theorem”. The theorem suggests that, as an implication of equilibrium in perfect capital markets, the choice of capital structure does not affect a firm’s market value. It is the assets of a firm that determine the value of the firm and not the way by which these assets are financed. The initial perfect market assumptions, on which the 1958 theory of Modigliani and Miller was based, were later reviewed in 1963 with the introduction of the tax benefits of debt. This is attributed to the fact that a perfect market

does not exist in the real world. Since interest on debt is tax-deductible, thereby creating tax savings for the borrower, it becomes possible for firms to minimize their costs of capital and maximize shareholders' wealth by using debt (Modigliani and Miller,1963).

According to Stiglitz and Weiss (1981) agency problems such as asymmetric information and moral hazards can impact on the availability of credit and hence the capital structure of new SMEs. Stiglitz and Weiss termed this phenomenon credit rationing. In the Stiglitz and Weiss formulation, credit rationing is said to occur among the loan applicants who appear to be identical, some receive credit while others do not; or there are identifiable groups in the population that are unable to obtain credit or can only obtain credit at much higher prices. The core of the argument is that suppliers of finance may choose (due to asymmetric information, adverse credit selection and monitoring problems) to offer an array of interest rates that would leave a significant number of potential borrowers without access to credit.

The pecking order theory by Myers (1984) suggests that there is no well-defined optimal capital structure; instead the debt ratio is the result of hierarchical financing over time. Management has a preference to choose internal financing before external financing. When a firm is forced to use external financing sources, managers select the least risky and demanding source first. When it is necessary to issue external sources, debt issuance is preferred to new equity. According to Coleman and Cohn (2000) commercial banks are a principal source of debt finance for new SMEs. Commercial banks offer new SMEs a wide range of services in their own right or through wholly or partially owned

subsidiaries. These services cover every aspect of the financial market such as overdraft facilities, term loans, trade bill financing, factoring, leasing, export and import finance, and even government loan guarantee schemes. Huyghebaert, Van de Gucht and Van de Hulle (2007) point out that trade credit arises when a firm purchases goods and services for which payment is delayed. Trade credit is usually extended for an intermediate period of thirty to sixty days at which point payment is due. If payment is not made on the date, financing charges are applied and trade credit becomes an alternative method of financing business expenses.

According to Berger and Udell (2006) recent evidence from developing countries suggests that trade credit provides a signal to the availability of more bank loans to new SMEs. Trade credit in economic environments with weak informational infrastructure and less developed banking systems can play an even more important role in SME financing because of its strength in addressing the information problem. The argument of this study is that there are certain variables in the business environment that constrain the availability of debt from commercial banks and trade creditors to new SMEs in South Africa. Smit, et,al (2007) define a business environment as all those factors or variables, both inside and outside the organization that may influence the continued and successful existence of the organization. According to Cassar (2004) in the capital structure context, the business environment consists of factors internal and external to the firm which can influence its access to debt and/or external equity. Coco (2000) points out that collateral helps to reduce informational asymmetries and moral hazard problems that arise between banks and entrepreneurs. Collateral can be repossessed by the creditor in case of default thus enhancing creditor protection. Kitindi,et al,. (2007) remark that creditors, banks and

other lenders use business information provided by firms to analyse their present performance and predict future performance. Business information reduces information asymmetry. If an entrepreneur has spent time developing a comprehensive and a priority business plan at an early stage in the project, the risk perception should be reduced and the likelihood of obtaining capital should increase. Studies by Shane and Stuart (2002) and Rudez and Mihalic (2007) positively associate managerial competencies with new venture performance. The higher the level of managerial competency exhibited by the owners of a new firm, the greater the viability and survival of the new SME. Coulthard and Loos (2007) describe networking in a small firm context as an activity in which the entrepreneurially oriented SME owner build and manage personal relationships with particular individuals in their surroundings.

Conclusively it can be deduced that a firm's financial constraints depends not only on the financial factors but also on the intervening factors such as legal environment to support growth mechanisms and the information systems through which relevant information can be passed over from one place to another regarding the prevailing circumstances that have effect on growth. Information asymmetry and weak formal contract enforcement systems are identified as some of the factors that can impede the growth of a firm.

The determinants of financial constraints in SMEs can be measured by firm size, ownership of the firm, age, education, professional experience, managerial skills, productivity, location of the firm, business strategies and production network.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter explains the research design, population of the study, sample size, data collection method and data analysis that were employed in the research under study.

3.2 Research Design

The study was based on the cross sectional survey design with data being collected from the existing enterprises. The survey design was chosen because it allows statistical inferences to the population being studied. Survey research usually uses questionnaires in order to determine the opinions, attitudes, preferences and perceptions of people in the research (Kathuri and Pals, 1993). Using the design, the determinants of financing constraints of SMEs were established.

3.3 Study Population

The population of study was 964 registered SMEs as per the Kenya National Chamber of Commerce and Industry (KNCCI) Kisumu chapter (2013). These are SMEs that are spread across the major urban centres in Kisumu County. They were randomly sampled to come up with a representative size that forms the basis of this study.

3.4 Sample Size

The sample was carefully selected to include small and medium size enterprises to enable the researcher come up with accurate information regarding the determinants of financing

constraints of SMEs. The simple random sampling was employed to select the SMEs to be sampled to come up with information on the determinants of financial constraints.

Since the population is less than 10000, Fisher et al (1983) recommends the following:

$$nf = n/1 + n/N$$

Where nf is the desired sample size when population is less than 10000

n = the desired sample size (when population is more than 10000) at 95% confidence level.

N = is the estimate of the population size.

The total population of the study is 964, therefore N = 964

Meaning $nf = 384/(1 + 384/964) = 384/1.39834024896 = 274$

The sample size was therefore 274 respondents.

3.5 Data Collection

The primary method of collecting data was employed to achieve the objective of study. The primary information was obtained from the entrepreneurs through field interviews and questionnaires. Both closed and open ended type of questionnaires were used to enable the interviewee have easy time in responding to the questions.

3.6 Data Analysis

Data analysis involves organizing, accounting for and explaining the data in terms of the respondents definition of the situation using patterns, themes and categories (Gay,1992). Data analysis has been done using descriptive statistics and exploratory factor analysis. The statistical package for social sciences (SPSS) was employed in analyzing data.

CHAPTER FOUR: DATA ANALYSIS RESULTS AND DISUSSIONS

4.1 Introduction

The study seeks to establish the determinants of financial constraints on small and medium enterprises in Kisumu County. The study targeted 274 small and medium enterprises within Kisumu County. The researcher managed to collect 100 completed questionnaires which were analysed using the parameters stated in the questionnaire in order to answer the objective of the research study.

The researcher used open and closed ended questionnaire to obtain the relevant data. This chapter presents the general information relating to: Sources of funding, financing options, Start up capital and findings of the study.

4.2 General Information

The following findings relates to the respondents personal information as obtained from the questionnaire. It relates to: - Gender of respondent, level of education, Number of employees.

4.2.1 Gender of respondents

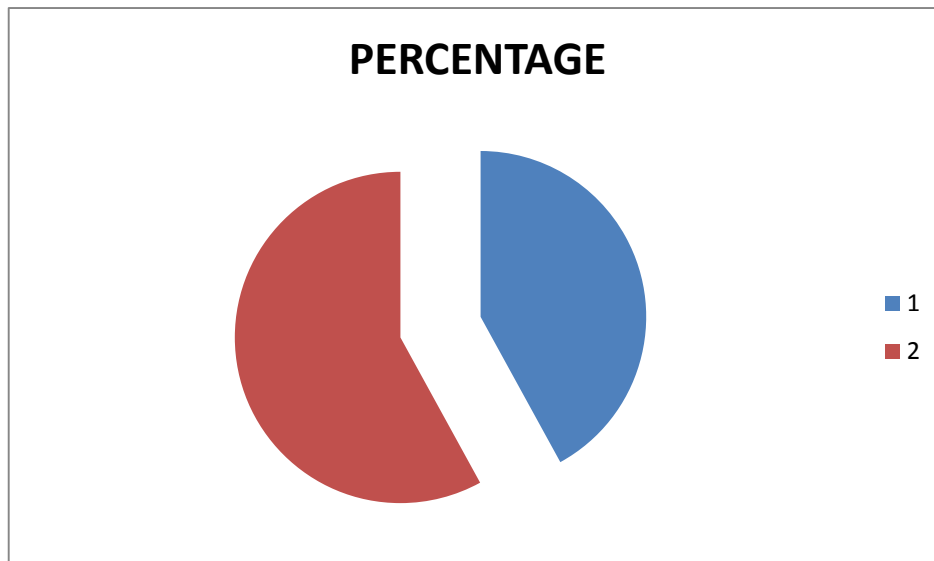
Majority of the respondents were male 58%, and male 42% as shown in table 4.1

Table 4.1 Gender of the respondents

Gender	Frequency	Percentage
MALE	42	42%
FEMALE	58	58%
Total	100	100%

Source Research Data

Figure 4.1 Gender of the respondents



4.2.2 Level of Education of respondents

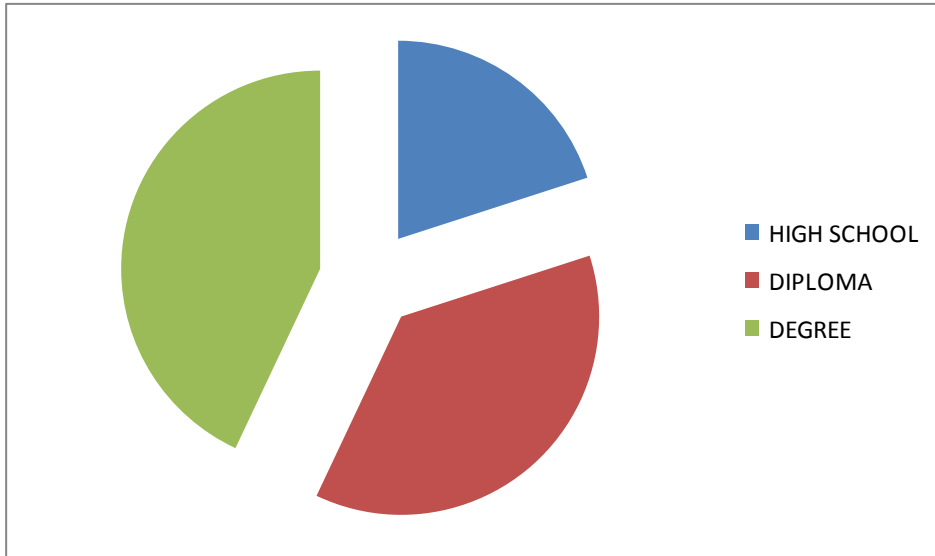
Majority of respondents indicated their level of Education was degree accounting for 43% of the respondents and diploma holders accounted for 37% of respondents and High school accounted for 20% of respondents.

Table 4.2 Level of Education of respondents

Level of education	Frequency	Percentage
HIGH SCHOOL	20	20%
DIPLOMA	37	37%
DEGREE	43	43%
Total	100	100%

Source Research Data

Figure 4.2 level of Education of Respondents



4.2.3 Duration in Business

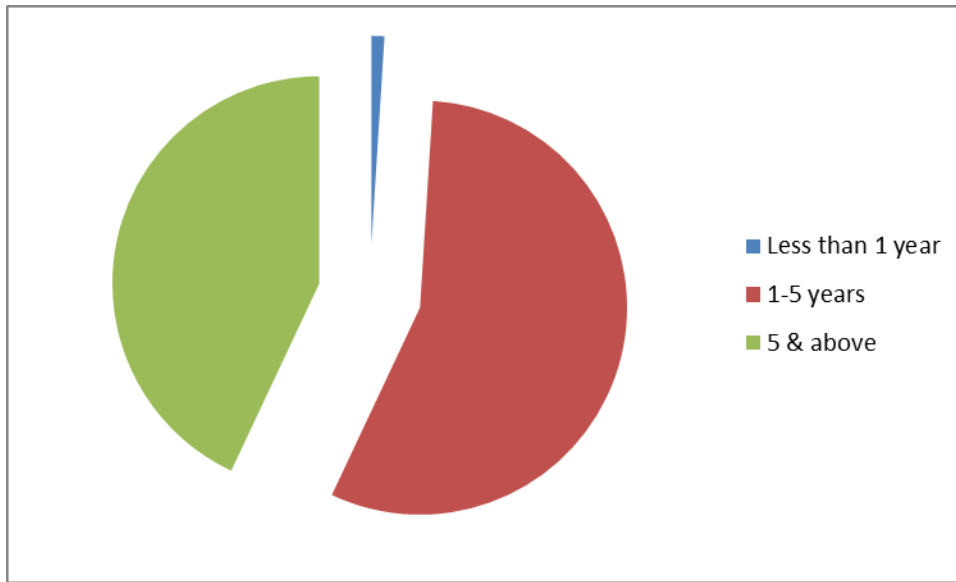
Majority of respondents indicated that they have been in business for more than 1 year. 56% respondents indicated that they had been in business for a period of one to five years while 43% revealed that they had been in business for period over five years and 1% less than one year.

Table 4.3 Duration in Business

Duration in business	Frequency	Percentage
Less than 1 year	1	1%
1-5 years	56	56%
5 & above	43	43%
Total	100	100%

Source Research Data

Figure 4.3 Duration in business



4.2.4 Start up Capital

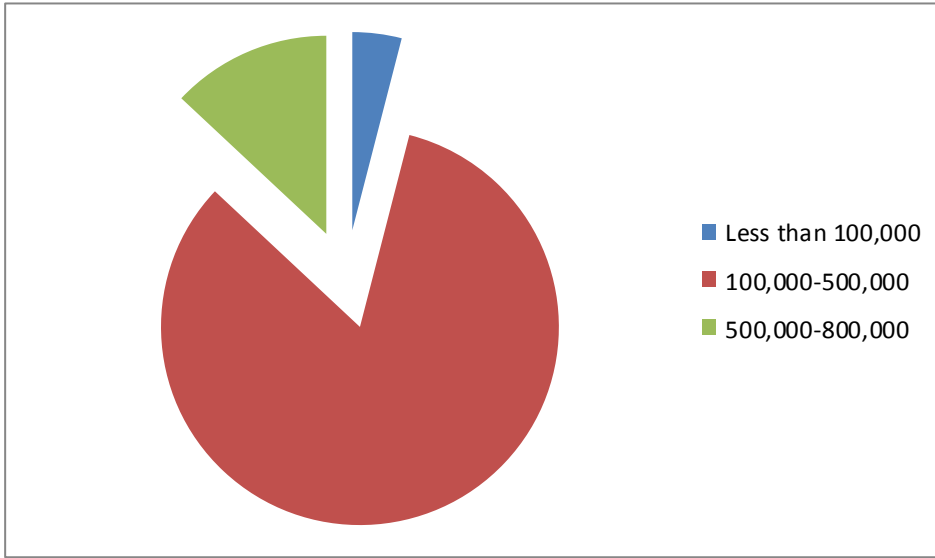
Majority of respondents indicated that start up capital required to start SME was 100,000 to 500,000. 13% of respondents revealed that a business required 500,000 and above as start up capital. Only 4% stated that they needed less than 100,000 to start up a business.

Table 4.4 Start up Capital

Capital	Frequency	Percentage
Less than 100,000	4	4%
100,000-500,000	83	83%
Above 500,000	13	13%
Total	100	100%

Source Research Data

Figure 4.4 start up capital



4.2.4 Number of Employees Business

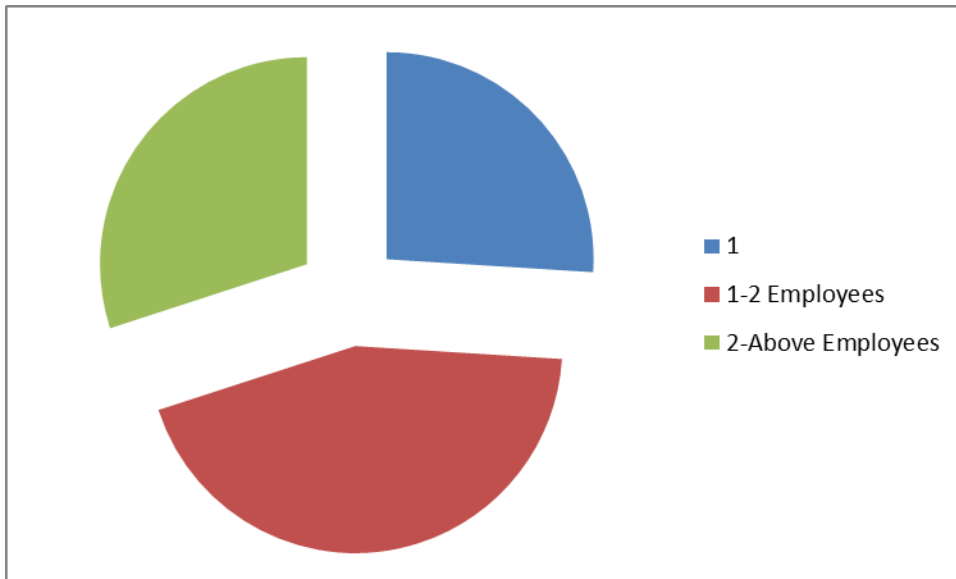
Majority respondents indicated that they employed more than one employee in their business. 44% engaged one to two people, 30% required two and above and only 26% required one employee.

Table 4.5 Number of employees

No	Frequency	Percentage
1 Employee	26	26%
1-2Employees	44	44%
2-Above Employees	30	30%
Total	100	100%

Source Research Data

Figure 4.5 Number of employees



4.3 Source of Financing

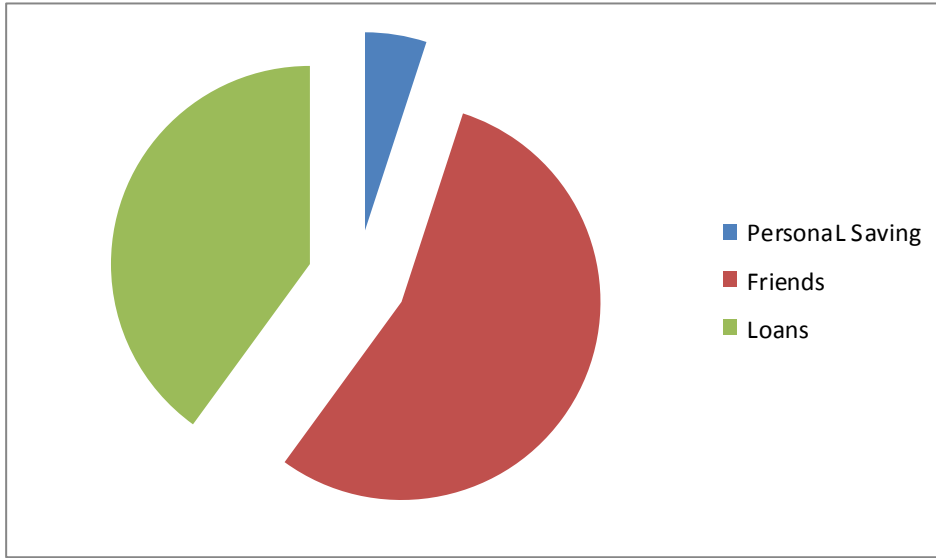
Majority of respondents indicated that contribution from friends was a major source of financing accounting for 55 % of respondents. 40% of respondents indicated that they are dependent on loans as a financing source and only 5% depended on personal savings.

Table 4.6 Source Financing

Source of financing	Frequency	Percentage
Personal Saving	5	5%
Friends	55	55%
Loans	40	40%
Total	100	100%

Source Research Data

Figure 4.6 Source of financing



4.6 Difficulty in sourcing of Funds

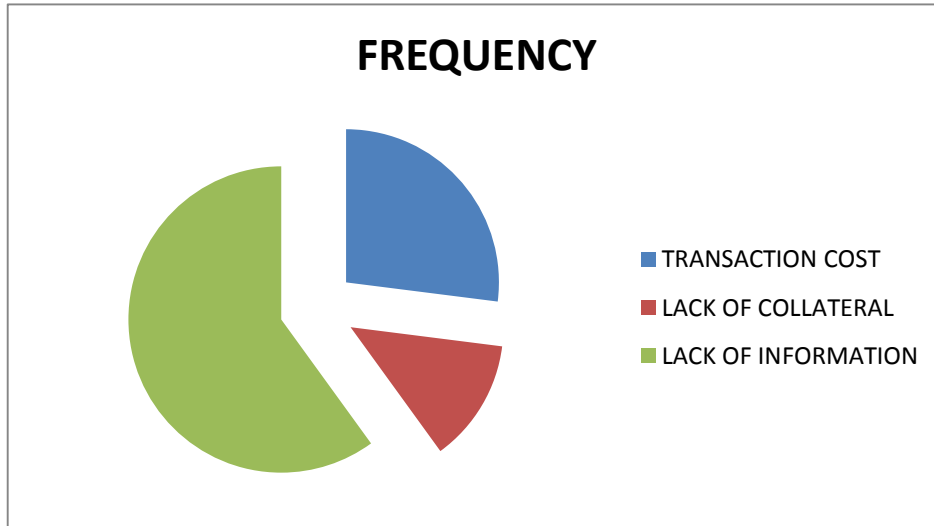
Majority of respondents indicated that lack of information was a major difficulty in sourcing funds accounting for 60% of respondents, 13% of respondents revealed that lack of collateral was major difficulty and 27% of respondents revealed that transaction costs costs was a major difficulty.

Table 4.7 Difficult in sourcing Finances

Difficult in sourcing funds	Frequency	Percentage
Transaction Cost	27	27%
Lack of Collateral	13	13%
Lack of Information	60	60%
Total	100	100%

Source Research Data

Figure 4.7 difficulties in sourcing finance.



4.7 Determinants of financial constraints

4.7.1 Size of the Firm

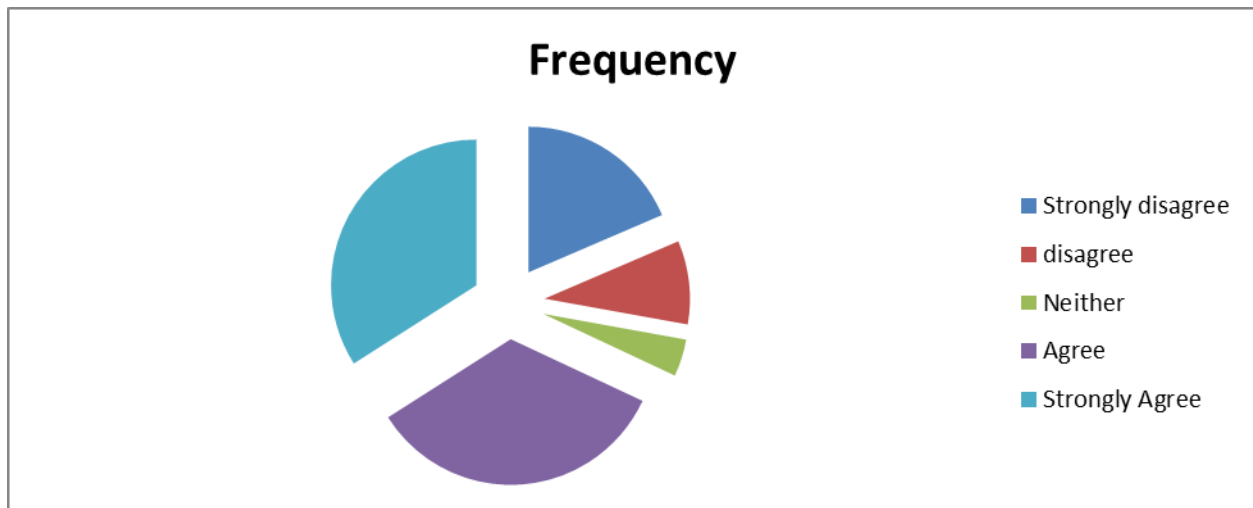
Majority of respondents agreed that size of the firm was a determinant of financial constraint: 34% agreed and 34% strongly agreed. However 19% of respondents strongly disagreed that size of firm was a determinant of financial constraint, 9% disagreed and 4% neither agreed nor disagreed.

Table 4.8 Size of the Firm

Size of the Firm	Frequency	Percentage
Strongly disagree	18	19%
Disagree	9	9%
Neither	4	4%
Agree	33	34%
Strongly Agree	33	34%
Total	97	100%

Source Research Data

Figure 4.8 size of the Firm



4.7.2 Age of the Firm

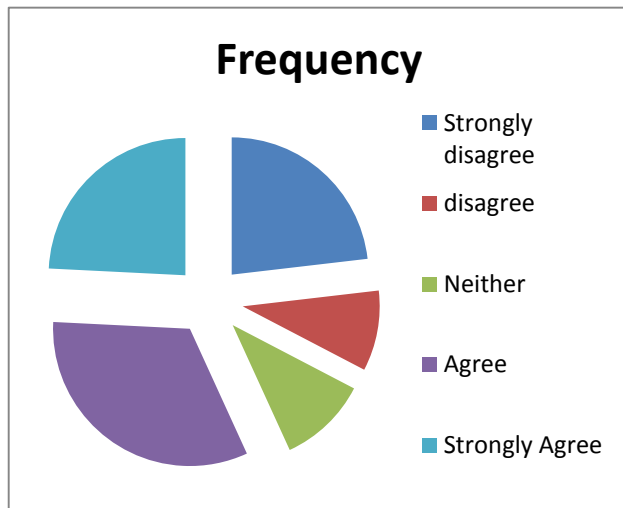
Majority of the respondents indicated that age of the firm was a determinant of financial constraints. 24% strongly agreed, 33% agreed, 11% neither agreed nor disagreed, 23% strongly disagreed and 9% disagreed.

Table 4.9 Age of the Firm

Age of the Firm	Frequency	Percentage
Strongly disagree	22	23%
Disagree	9	9%
Neither	10	11%
Agree	31	33%
Strongly Agree	23	24%
Total	95	100%

Source Research Data

Figure 4.9 Age of the Firm



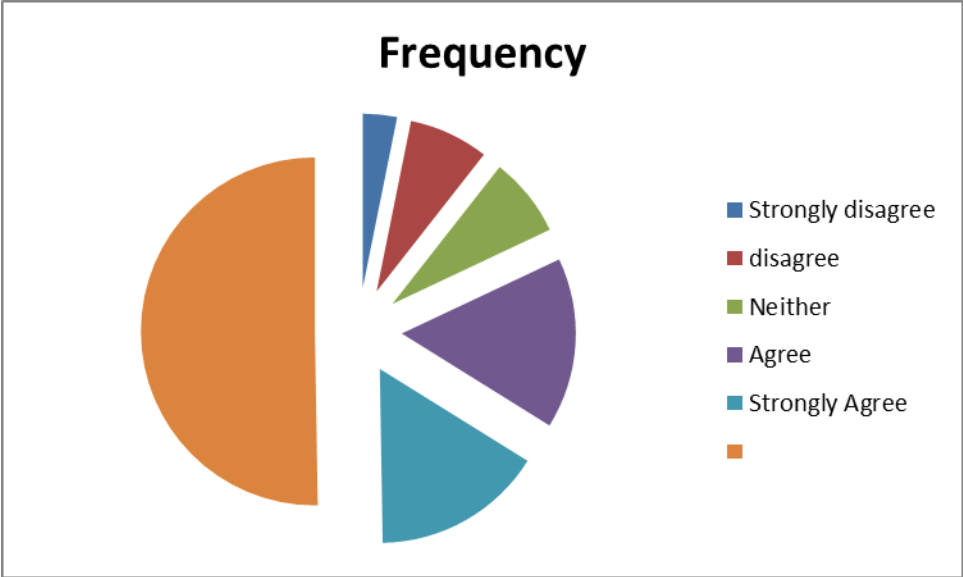
4.7.3 Firm Ownership

Majority of respondents revealed that Firm ownership was a determinant of financial constraint. 32% strongly agreed, 32% agreed, 15% neither agreed nor disagreed, 6% strongly disagreed and 15% disagreed.

Table 4.10 Firm ownership

Firm ownership	Frequency	Percentage
Strongly disagree	6	6%
Disagree	14	15%
Neither	14	15%
Agree	30	32%
Strongly Agree	30	32%
Total	95	100%

Source Research Data.



4.7.4 Professional Experience

Majority of the respondents revealed that professional experience was a determinant of financial constraint. 28% strongly agreed, 31% agreed, 17% neither agreed nor disagreed 13% strongly disagreed, 13% disagreed.

Table 4.11 Professional Experience

Professional Experience	Frequency	Percentage
Strongly disagree	12	13%
Disagree	12	13%
Neither	16	17%
Agree	29	31%
Strongly Agree	27	28%
Total	95	100%

Source Research Data.

4.7.5 Level of Education

Majority of the respondents indicated that level of Education was a determinant of financial constraint. 28% strongly agreed, 31% agreed, 18% neither agreed nor disagreed, 9% strongly disagreed, and 12% disagreed.

Table 4.12 Level of Education

Level of Education	Frequency	Percentage
Strongly disagree	9	9%
Disagree	11	12%
Neither	17	18%
Agree	29	31%
Strongly Agree	27	28%
Total	95	100%

Source Research Data

4.7.6 Strategies and networking

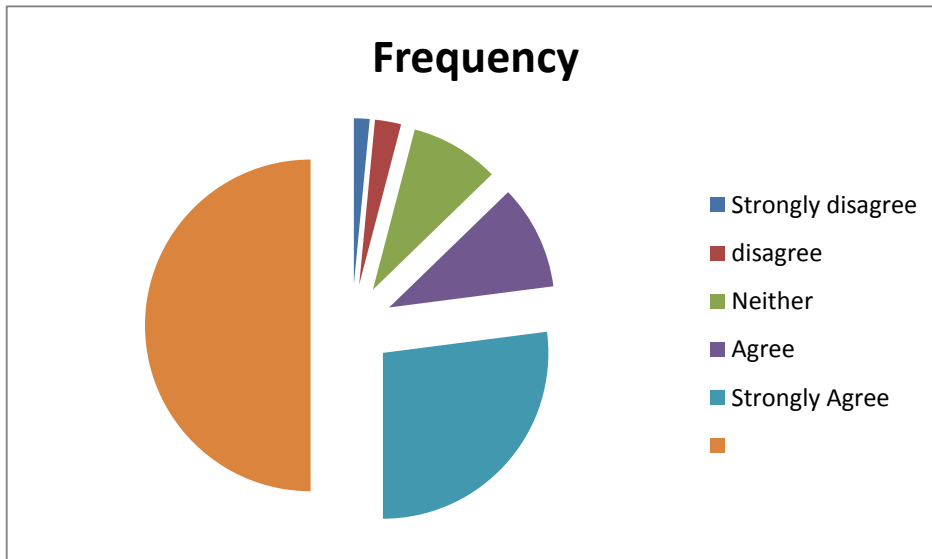
Majority of the respondents revealed that strategies and networking are determinants of financial constraints. 54% strongly agreed, 20% agreed, 17% neither agreed nor disagreed, 3% strongly disagreed and 5% disagreed.

Table 4.13 Strategies and networking

Strategies and networking	Frequency	Percentage
Strongly disagree	3	3%
Disagree	5	5%
Neither	17	17%
Agree	20	20%
Strongly Agree	53	54%
Total	98	100%

Source Research Data

Figure 4.13 Strategies and networking



4.8 Descriptive Statistics

The descriptive statistics for the variables have been obtained for empirical investigation and are presented in the Table 4.14. The variables are level of education of respondents, duration in business, no of employees, startup capital, and growth of business.

Table 4.14 Descriptive Statistics

Descriptive Variables	N	Minimum	Maximum	Mean	Std. Deviation
Level of education of respondents	100	1.00	3.00	1.7200	.73964
Duration in business	100	1	9	2.18	1.553
No of employees	100	1.00	9.00	2.4400	1.84949
Startup capital	100	1.00	3.00	1.4600	.65782
Determinant	100	1	9	3.76	1.832
Growth of business	100	1	2	1.04	.197
Valid N (listwise)	100				

Source Research Data

4.7 Discussion

The study looked at the determinants of financial constraints on SMEs in Kisumu county. In the study it was established that majority of the respondents indicated level of education as a major factor in determining access to finance with degree holders accounting for 43% of the respondents, diploma holders accounted for 37% of respondents and High school level accounted for 20% of the respondents. On the duration of business, majority of respondents indicated that their duration in business was more than 1 year. 56% of the respondents indicated that they had been in business for a period of 1 to 5 years, 43% revealed that they had been in business for period over 5 years.

For start up capital majority of respondents indicated that startup capital required to start a SME was between Kshs100,000 to Kshs500,000. 13% of respondents revealed that a business required Kshs500,000 and above as start up capital. Only 4% stated that they needed less than Kshs 100,000 to start up a business.

Majority respondents indicated that they employed more than one employee in their businesses, 44% engaged one, 30% engaged two and above and only 26% required one employee.

On the source of financing, majority of the respondents indicated that contribution from friends was a major source of financing accounting for 55 % of the respondents, 40% of the respondents indicated that they depended on loans as a financing source and only 5% depended on personal savings.

On difficulty in sourcing for funds, majority of respondents indicated that lack of information was a major contributor to difficulty in sourcing for funds and this accounted for 60% of the respondents. 13% of the respondents revealed that lack of collateral was major obstacle to funds

access and 27% of the respondents revealed that transaction costs was their major impediment to funds access.

On firm size, majority of the respondents agreed that size of the firm was a determinant of financial constraint. 34% agreed and 34% strongly agreed. However 19% of the respondents strongly disagreed that size of firm was a determinant of financial constraint, 9% disagreed while 4% neither agreed nor disagreed.

Majority of the respondents revealed that age of the firm was a determinant of financial constraint. 24% strongly agreed, 33% agreed, 11% neither agreed nor disagreed, 23% strongly disagreed and 9% disagreed.

On firm ownership, majority of the respondents indicated firm ownership as a determinant of financial constraint. 32% strongly agreed, 32% agreed, 15% neither agreed nor disagreed, 6% strongly disagreed and 15% disagreed.

Majority of respondents indicated professional experience as a determinant of financial constraint. 28% strongly agreed, 31% agreed, 17% neither agreed nor disagreed, 13% strongly disagree while 13% disagreed.

On the level of education, majority of respondents revealed that level of Education was a determinant of financial constraint. 28% strongly agreed, 31% agreed, 18% neither agreed nor disagreed, 9% strongly disagreed and 12% disagreed.

On strategies and networking, majority of respondents indicated strategies and networking as determinants of financial constraint. 54% strongly agreed, 20% agreed, 17% neither agreed nor disagreed, 3% strongly disagreed while 5% disagreed.

Overallly information asymmetry was cited as a major impediment to sourcing of funds followed by transaction cost and lack of collateral in that order. The major determinants of financial

constraints was agreed to most respondents as business strategies and networking at 74%, followed by size of the firm and firm ownership having a tie at 64%, professional experience and level of education at 59% while age of the firm was the least determinant at 47%.

This study agreed with other empirical studies and theories over the years attempting to explain the constraints that Small and Medium Enterprises have faced in their efforts to achieve growth. Access to finance has been rated as major constraint by around 30% of small and medium enterprises, a similar proportion as economic policy uncertainty and corruption.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary of the key findings presented in chapter four, and conclusions drawn based on such findings and recommendations. The objective of the study was to establish the determinants of financial constraints on SMEs in Kisumu County. This chapter has three sub-sections namely; the first section that deals with summary and conclusion, the second is limitations of the study and lastly recommendations and suggestions for further research.

5.2 Summary

The objective of the study was to establish the determinants of financial constraints of SMEs in Kisumu County. The data that the study was based on are existing SMEs in Kisumu county of which 274 were sampled and 100 responses received to form the basis of analysis of the study. The study found that different variables impact on the access to finances by SMEs as outlined in chapter four and these include firm size, firm ownership, business strategies and networking, age of the firm, level of education and professional experience. Other factors like information asymmetry, transaction costs and lack of collateral are also observed as impediments to sourcing of funds hence the need to address these factors.

5.3 Conclusion

Conclusively it was established that a majority of respondents indicated that contribution from friends was their major source of financing accounting for 55 % of the respondents, 40% of respondents indicated that they depended on loans as a financing source and only 5% depended on personal savings. Majority of the respondents indicated that lack of information was major

difficulty in sourcing funds and this accounted for 60% of the respondents. 13% of the respondents revealed that lack of collateral was a major difficulty and 27% of the respondents indicated that transaction costs were a major difficulty. Majority of respondents agreed or strongly agreed that all the observed variables were determinants of financial constraints and these include:- Size of the firm, age of the firm, firm ownership, professional experience, level of education, business strategies and location of the firm. The study also revealed that majority of the respondents listed access to finance as a major obstacle to growth hence majority believed that with improved financing their firms could perform better and compete effectively with other business ventures in similar traits. This study agreed with other empirical studies and theories over the years attempting to explain the constraints that Small and Medium Enterprises have faced in their efforts to achieve growth.

5.4 Limitations of the Study

The research study did not go without challenges. The research was faced with several challenges which almost ended with discontinuation. Of the 274 respondents supplied with questionnaires, only 100 managed to respond to the questions fast enough while the rest responded halfway or did not respond at all thus increasing the missing values. This delayed the analysis of the findings and restricted the analysis to only those who responded completely. Some of the respondents took the research exercise so casually and this may have led to loss of very vital information that would have enriched the findings.

Obtaining primary data was difficult because some the respondents hesitated to divulge information either because of suspicion or expectation of rewards. Walking around from one

business enterprise to another also proved a challenge and it took quite some weeks to conclude the data collection exercise.

5.5 Recommendations for Future Research

To complete this research, areas that need to be looked into include; the reason why information asymmetry is cited as a major impediment to firm's access of funds. The other area for future research is why strategies and networking take the lead in determining financial constraints of most firms overtaking the traditional variables like firm size and ownership. It is also important that studies are conducted to determine if the effort by government to address these obstacles through funding agencies is yielding any fruits.

Other researchers, academicians and students who may have an interest in this area of study should take a keen look at strategies and networking as critical factors and explore more on why they lead in determining financial constraints.

REFERENCES

- Philip & Henault, George, (1995). *Agents of Change: Studies on the Policy Environment for Small Enterprise in Africa*, International Development Research Center.
- Ayyagari, Meghana, Thorsten, B., Asli, D., (2005). *Small and Medium Enterprises across the Globe: World Bank Policy Research Working Paper 3127*.
- Beck, Thorsten, Asli, D., & Levine, R., (2005). *SMEs, Growth, and Poverty*. Journal of Economic Growth 10, 197-227.
- Levine, R., (2006). *Should Governments and Aid Agencies Subsidize Small Firms? Challenges for Development of Vietnam's Most Important SMEs*, Policy Brief
- William, D., (2005). *Transforming the Developing Landscape & the Role of the Private Sector*, Brookings Institution.
- Zavatta, R., L., Amati, & Bruin, G., D., (2006). *Info Dev Study on Addressing the Financing Gap for Technology Entrepreneurs in Developing Countries: Preliminary Findings and Recommendations*, April.
- Kakuru, J., (2008). *The supply-demand factors interface and credit flow to small and micro enterprises smes: Uganda*.
- Kira, A., R., (2013). *Determinants of Financing Constraints in East African Countries' SMEs*. International Journal of Business and Management; Vol. 8, No. 8; 2013
- Wanjau, K., L., Gakure, W., & Kahiri, J., (2007). *The role of quality in growth of small and medium enterprises and economic development in Kenya*, Project, JKUAT.

- Brealy & Myers, (July 1984). *Pecking order theory: The capital structure puzzle*, Journal of Finance, P.581.
- Betty, K., (2011). *A survey of financial constraints hindering growth of SMEs in Kenya*
- Barton, S., L., & C.H., Matthews. *Small Firm Financing: Implications From a Strategic Management Perspective*. Journal of Small Business Management 27 (1989).
- Becchetti, L., and G. Trovato. *"The Determinants of Firm Growth for Small and Medium Sized Firms. The Role of the Availability of External Finance."* Small Business Economics 19, no. 4 (2002)
- Beck, Thorsten, Demirgüç-Kunt Asli, and Vojislav Maksimovic. *"Financial and Legal Constraints to Growth: Does firm size matter?"* The journal of finance, 2005
- Berger, A. N., and G. F. Udell. *"Small firms, Commercial Lines of Credit, and Collateral."* Journal of business 68 (1995)
- Berger, Allen N., & F. Gregory Udell. *"A More Complete Conceptual Framework for SME Finance."* World Bank Conference on Small and Medium Enterprises: Overcoming Growth Constraints. Washington D.C.: World Bank, MC 13-121, 2004.
- Berger, Allen N., and F. Gregory Udell. *"Small Business Credit Availability and Relationship Lending: The importance of Bank Organisational Structure."* The Economic Journal 112, no. 477 (2002)

- Berger, Allen N., and F. Gregory Udell. "*The Economics of Small Business Finance: The Role of Private Equity and Debt Markets in the Financial Growth Cycle.*" *Journal of Banking and Finance*, 1998
- Berger, Allen N., Hasan Iftekhhar, and Klapper F. Leora. "*Further Evidence on The Link Between Finance and Growth: An International Analysis of Community Banking and Economic Performance.*" *Journal of Financial Services Research* 25 (2004)
- Bhaird, Ciarán Mac an. *Resourcing Small and Medium Sized Enterprises: A Financial Growth Life Cycle Approach.* Dublin: Springer Heidelberg Dordrecht London New York, 2010.
- Bryman, Alan, and Emma Bell. *Business Research Methods.* (2nd Ed.). New York: Oxford University Press Inc., 2007.
- Carpenter, Robert E., and Bruce C. Peterson. "*Is the Growth of Small Firms Constrained by Internal Finance?*" *Review of Economics and Statistics* 84, no. 2 (2002).
- European commission, Directorate-General for Enterprise and Industry. *Final Report of The Expert Group on Supporting The Internationalisation of SMEs. Promotion of SME competitiveness, Brussel, Belgium:* Directorate-General for Enterprise and Industry, 2007.
- European Central Bank. *Survey on The Access to Finance of SME's in The Euro Area.* Survey, European Central Bank, 2011.
- European Union. "*Commission Recommendation of 6 May Concerning The Definition of Micro, Small and Medium-Sized Enterprises.*" *Official Journal of the European Union*, May 2003.

- Hall, Graham C., Patrick J Hutchinson, and Nicos Michaelas. *"Determinants of The Capital Structure of European SMEs."* Journal of Business Finance and Accounting, 2004.
- Headd, Brian. *"Redefining Business Success: Distinguishing Between Closure and Failure."* Small Business Economics 21, no. 1 (2003).
- Hollenstein, Heinz. *"Determinants of International Activities: Are SMEs Different?"* Small Business Economics 24 (2005).
- Hutchinson, Karise, Emma Fleck, and Lester Lloyd-Reason. *"An Investigation Into The Initial Barriers to Internationalization: Evidence From Small UK Retailers."* Journal of Small Business and Enterprise Development 16, no. 4 (2009).
- Kon, Y., and D. J. Storey. *"A Theory of Discouraged Borrowers."* Small Business Economics 21 (2003).
- Kraemer-Eis, Helmut, Markus Schaber, and Alessandro Tappi. *SME loan securitization: An important toll to support European SME lending.* EIF Research & Market Analysis, Luxembourg: European Investment Fund, 2010.
- Kristensen, Knud, and Gitte Larsen, interview by Gunnar Ingólfsson. *Sme financing constraints* (August 18, 2011).
- Lee, Khai S, Guan H Lim, and Soo J Tan. *"Dealing with Resource Disadvantage: Generic Strategies for SME's."* Small Business Economics, January 20, 1999.
- Levenson, Alec R., and Kristen L. Willard. *"Do Firms Get the Financing They Want? Measuring Credit Rationing Experienced by Small Businesses in the U.S."* Small Business Economics, no. 14 (2000).

- Lu, Jane W, and Paul W Beamish. *"The Internationalization and Performance of SMEs."* Strategic Management Journal 22 (Jun/Jul 2001)
- Maeseneire, Wouter, and Tine Claeys. *"Smes, fdi and financial constraints."* ssrn working Paper, 968694, 2007.
- McMahon, Richard G. P., and Leslie G. Davies. *"Financial Reporting and Analysis Practice in Small Enterprises: Their Association With Growth Rate and Financial Performance."* Journal of Small Business Management 32, no. 1 (1994)
- Mercieca, Steve, Klaus Schaeck, and Simon Wolfe. *"Bank Market Structure, Competition, and SME financing Relationships in European Regions."* Journal of Financial Services Research 36 (2009)
- Mills, J., A. Bonner, and K. Francis. *"The Development of Constructivist Grounded Theory."* International Journal of Qualitative Methods, 2006.
- OECD. *Removing Barriers to SME Access to International Markets. Organisation for economic co-operation and development*, OECD Publishing, 2008.
- Petersen, M., and R. Rajan. *"The Benefits of Firm-Creditor Relationships: Evidence from Small Business Data."* Journal of Finance 49 (1994)
- Pettit, Richardson R., & Ronald F. Singer. *"Small Business Finance: A Research Agenda."* Financial Management 14, no. 3 (1985)
- Poutziouris, Panikkos Zata. *"The Financial Affairs of Smaller Family Companies."* In *Understanding the Small Family Business*, by Denise E. Fletcher, 111-126. London: Routledge, 2002.

- Ruzzier, Mitja, Robert D Hisrich, and Bostjan Anoncic. *"SME Internationalization Research: Past, Present, and Future."* Journal of Small Business and Enterprise Development, 2006.
- Beck, T. and Demirguc-Kunt, A., and Maksimovic, V. (2005) *Financial and Legal Constraints to Firm Growth: Does Firm Size Matter*, Journal of Finance, 137-177.
- Beck, T. and Demirguc-Kunt, A., and Martinez Peria, M. S. (2008) *Bank Financing for SMEs around the World: Drivers, Obstacles, Business Models, and Lending Practices*, Policy Research Working Paper Series 4785, The World Bank
- Berger, A.N. and Udell G.F. (1998) *The Economics of Small Business Finance: The Roles of Private equity and debt markets in the financial growth cycle*, Journal of Banking and Finance, 22, 613-673.
- Berger, A.N. and Udell G.F. (2003) *Small Business and Debt finance*, *Handbook of Entrepreneurship Research*, 13, 299-328.
- Berger, A.N. and Udell G.F. (2005) *A More Complete Conceptual Framework for Financing of Small and Medium Enterprises*, World Bank Policy Research Working Paper no.3795.
- Bruhn-Leon, B. and Eriksson, P-E and Kraemer-Els, H. (2012) *Progress for Microfinance in Europe*, *European Investment Fund Working Paper no. 13*.
- Caccavaio, M. and Carmassi, J. and Di Giorgio, G. and Spallone, M. (2012) *SMEs and the Challenge of Going Public: Evidence from a Recent Survey*, CASMEF Working Paper no.2.

- Cook, O. and Tang, T. (2010) *Macroeconomic Conditions and Capital Structure Adjustment Speed*, Journal of Corporate Finance 16(1), 73-87.
- Dolignon, C. and Roger, F. (2010) *Transmission of Financial Shocks to The Real Economy: The Impact of The Financial Accelerator*, Working Paper Amundi no.460
- European Central Bank (2011), *Survey on The Access to Finance of Small and Medium-Sized Enterprises in the Euro Area*, December 2011.
- European Central Bank (2012c), *Survey on The Access to Finance of Small and Medium-Sized Enterprises in the Euro Area*, April 2012.
- Fama, E. and K.R. French, (2002) *Testing Trade-Off and Pecking Order Predictions about Dividends and Debt*, The Review of Financial Studies 15, 1-33
- Frank, M.Z. and Goyal, V.K. (2003), *Testing the Pecking Order Theory of Capital Structure*, Journal of Financial Economics, vol.67, 217-248.
- Hackbarth, D. and Miao, J. and Morellec, E. (2006) *Capital Structure, Credit Risk and Macroeconomic Conditions*, Journal of Financial Economics 82, 519-550.61
- International Finance Corporation (2010a), *The SME Banking Knowledge Guide*, (2nd Ed.). The World Bank, Washington, D.C.
- IFC (2010b), *Scaling Up SMEs Access to Financial Services in the Developing World. IFC and McKinsey & Company (2010), Two trillion and counting: Assessing and Mapping the Gap in Micro, Small and Medium Enterprise Finance.*

- Jensen, M.C. and Meckling W.H. (1976), *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, Journal of Financial Economics 3(4), 305-360
- Kelly, R. and Kraemer-Els, H. (2011), *European Small Business Finance Outlook*, European Investment Fund Working Paper no. 10.
- Korajczyk, R.A. and Levy, A. (2003) *Capital Structure Choice: Macroeconomic Conditions and Financial Constraints*, Journal of Financial Economics 68, 75-109
- Maksimovic, V. and Demircug-Kunt, A. and Ayyagari, M. (2006) *How Important are Financing Constraints? The Role of Finance in the Business Environment*, World Bank Policy Research Working Paper no. 3820.
- Modigliani, F. and Miller, M. (1958) *The Cost of Capital, Corporation Finance and the Theory of Investment*, American Economic Review 48(3), 261-297.
- OECD (2006), *The SME Financing Gap (Vol. I): Theory and Evidence*. Park, JH and Lim, BC and Koo, JH (2008), *Developing the Capital Market to Widen and Diversify SME Financing: The Korean Experience*, Korea Institute of Finance.
- Ross, S.A. (1977) *The Determination of Financial Structure: The Incentive-Signaling Approach*, The Bell Journal of Economics 8(1), 23-40.
- Saurina, J. and Trucharte, C. (2004) *The Impact of Basel II on Lending to Small- and Medium-Sized Firms: A Regulatory Policy Assessment Based on Spanish Credit Register Data*, Journal of Financial Services Research 26(2), 121-144.62

- Taketa, K. and Udell, G. (2007), *Lending Channels and Financial Shocks: The Case of Small and Medium-Sized Enterprise Trade Credit and the Japanese Banking Crisis*, *Monetary and Economic Studies* 25(2), 1-44.
- Ayyagari, M., T. Beck, and A. Demirgüç-Kunt (2007). *Small and Medium Enterprises Across the Globe*. *Small Business Economics*, vol. 29, p. 415.
- Beck, T., and A. Demirgüç-Kunt (2005). *Small and Medium-Size Enterprises: Overcoming Growth Constraints*. Policy Research Working Paper, No. WPS3127. Washington, D.C.: World Bank. (2006).
- Beck, T., A. Demirgüç-Kunt, and V. Maksimovic (2005). *Financial and legal constraints to growth: does size matter?* *Journal of Finance*, vol. 60, pp. 137-177.
- Beck, T., A. Demirgüç-Kunt, and M.S.M. Peria (2008). *Bank Financing of SMEs around the world: Drivers, obstacles, business models, and lending practices*. Policy Research Working Paper, No. WPS4785. Washington, D.C.: World Bank.
- Beck, T. , L.F. Klapper, and J.C. Mendozae (2010). *The typology of partial credit guarantee funds around the world*. *Journal of Financial Stability*, vol. 6, pp. 10-25
- Beck, T., and others (2006). *The determinants of Financing obstacles*. *Journal of International Money and Finance*, vol. 25, pp. 932-952.
- Berger, A, and G. Udell (1998). *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in The Financial Growth Cycle*. *Journal of Banking and Finance*, vol. 22, pp. 613-673.
- Birch, D., and others (1999). *Corporate Demographics*. Cambridge, MA: Cognetics.

- Bryman, B. and Bell, E. (2007) *Business Research Methods*, 2nd (Ed.). Oxford University Press.
- Bryman, B. and Bell, E. (2011) *Business Research Methods*, 3rd (Ed.). Oxford: Oxford University Press.
- Crotty, M. (1998) *The Foundations of Social Research: Meaning and Perspective in The Research Process*, London: Sage.
- Eisenhardt, K.M. (1989) "Building Theories from Case Study Research", *The Academy of Management Review*, Vol.14 No,4, pp.532-550.
- Eisenhardt, K.M. (2007) *Theory Building from Cases: Opportunities and Challenges*", *Academy of Management Journal*, Vol.50 No.1, pp.25-32.
- Flick, U. (2009) *An Introduction to Qualitative Research: Theory, method and applications*, 4th (Ed.). London: Sage.
- G., Gubrium, J.F. and Silverman, D. (Eds.) *Qualitative Research Practice*. London: Sage, pp.443-459.
- King, N. (2004) "Using Interviews in Qualitative Research", in Cassell, C. and Symon, G. *Essential Guide to Qualitative Methods in Organizational Research* 2nd (Ed.). London: Sage, pp.11-22.
- Social Sciences", in Denzin, N.K. and Lincoln Y.S. (Eds.) *The Sage Handbook of Qualitative Research*, 4th (Ed.). Thousand Oaks, California 91320: Sage Publications Inc, pp.27-42.
- Patton, M.Q. (2002) *Qualitative Research & Evaluation Methods*, 3rd ed. London:

Riege, A.M. (2003) "Validity and reliability tests in case study research: a literature review with "hands-on" applications for each research phase", *Qualitative Market*

Saunders, M., Lewis, P. and Thornill, A. (2007) *Research Methods for Business*

The Sage Handbook of Qualitative Research, 3rd (Ed.). London:Sage, pp.443-466.

Stake, R.E. (1995) *The Art of Case Study Research*, Thousand Oaks, California 91320: Sage Publications, Inc.

Stavros, C. and Westberg, K. (2009) "Using triangulation and multiple case studies to advance relationship marketing theory", *Qualitative Market Research: An International Journal*, Vol.12 No.3, pp.307-320.

Organizational Research", in Cassell, C. and Symon, G. (Eds.) *Essential Guide to Qualitative Methods in Organizational Research*, London: Sage, pp.1-10.

Warren, C.A.B. (2002) "Qualitative Interviewing", in Gubrium, J.F. and Holstein, J.A. (Eds.) *Handbook of Interview Research: Context and Method*. London: Sage, pp.83- 101. Yin, R.K. (2009) *Case Study Research: Design and Methods*, 4th, (Ed.). London: Sage.

Appendix

Questionnaire for the study

THE EFFECT OF FINANCIAL CONSTRAINTS ON THE GROWTH OF SMALL AND MEDIUM ENTERPRISES IN KISUMU COUNTY

Note:

The information you give will be useful for the purpose of this study ONLY and shall be treated with the confidentiality deserved.

Please put a tick () in the box next to the right response

NAME _____ (Option)

DESIGNATION _____

1. What is your gender? Male Female
2. What is your level of education? High school Diploma Degree
3. How many years have you been in this business? Less than 1 yr 1-5 yrs 5 yrs & above
4. How many employees do you have? 1 1-2 2 and above
5. How many employees did you start with? _____
6. How much was your startup capital? Less than Ksh 100,000 Ksh 100,000-500,000
Ksh 500,000 above
7. How did you source your funding? Personal savings Contribution from friends
Loans from financial institutions
8. Did you experience any difficulties in sourcing funds? Yes No
9. Identify the difficulties. Transaction Cost Lack of collateral Lack of
information
10. Which financing option did you go for? Loan from bank Trade credit
Borrowing from friends
11. Which option do you consider suitable to you and why? _____
12. If you were given another chance, would consider the same option? Yes No
13. What challenges did you experience in your choice of financing option?

14. What other financing options have you heard of or used apart from the ones specified above?

15. What were the main requirements in accessing finances in your choice of funding?

16. How did you manage to fulfill these requirements? _____
17. Which was the most needed requirement? _____
18. Do you consider this requirement to apply to other people in a similar business or it was only limited to you? _____
19. Do you know of other businesses which operate the same business as yours? Yes No
20. If yes have they shared their experiences with you on their financial constraints?

21. What did you get from them as the most constraining factors in accessing funds?

22. In your opinion do you think that these factors cut across small and medium enterprises in Kisumu

23. Considering how long you have been in the business, do you think you achieved any growth from where you started your business? _____
24. What would you attribute your growth to if any? _____
25. What do you think should be done differently to enable SMEs access finance without difficulties? _____
26. Which source of funding do you consider most accessible? _____
27. How would you rate this source vis a vis other sources _____

Kindly fill in the Likert scale below to identify the determinants of financial constraints based on the listed factors in the scale by ticking the appropriate box using the parameters from **strongly disagree** to **strongly agree**.

1. Strongly disagree
2. Disagree
3. Neither agree nor disagree
4. Agree
5. Strongly agree

Factors	1	2	3	4	5
Size of the firm					
Age of the firm					
Firm ownership					
professional experience					
Level of Education					
Business Strategies & Networking					
Location of the firm					