THE RELATIONSHIP BETWEEN ACCESS TO CREDIT AND FINANCIAL GROWTH OF SMALL AND MEDIUM ENTERPRISES IN NAIROBI COUNTY

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DECLARATION

I, Nathan Mwangi, hereby declare that this is my original work and has not been submitted for presentation and examination for any award of Degree in this university or any other university.

Signature…………………………………… Date…………………………

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This research project has been submitted for examination with my approval as the University of Nairobi supervisor

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To my family and friends for their honest support and encouragement during the study, to all of you, kindly accept my appreciation for your great support.
DEDICATION

I wish to dedicate this project to my family and my friends who gave me the moral support and encouraged me when writing this project.
ABSTRACT

The ability to access affordable credit is a critical element of private sector led growth, particularly for small businesses that often lack the initial capital needed to grow and expand and also for agricultural households, where expenditures on inputs precede the returns from harvest; it also increases a business or household’s ability to bear and cope with risk. This study sought to establish the relationship of access to credit on financial growth of SMEs in Nairobi County.

To achieve the objective of this study; a descriptive survey design was used. The population of this study was SMEs registered in Nairobi County. The researcher did a cluster sampling of 40 small and medium enterprises in Nairobi based on geographical locations. Four main streets namely: Moi Avenue, Kenyatta Avenue, River Road and Tom Mboya Street were selected. The study used secondary sources of data. Secondary data was sourced from the financial records of the SMEs from year 2009 to 2013. Other sources of secondary data included relevant literature and records from the library. Access to credit was measured through checking the loan book records from SMEs, asset turnover was measured using sales revenue divided total assets while the size of the firm was measured using the return on sales which is net income divided by sales. The dependent variable was financial growth which was measured using increase in net assets. Data collected was purely quantitative and it was analyzed using descriptive analysis. Regression analysis was used to come up with the model. The study used a multiple regression equation. Provision of credit to SMEs is still a fundamental problem faced by most owners and managers of SMEs since most of them lack security or collateral to be able to access credit facilities.

The findings of the study revealed that a few owners of SMEs that obtained credit were able to grow and expand their businesses significantly.
The study findings established that there was a positive relationship \((R= 0.986)\) between the variables. The study also revealed that 97.3% of financial growth in the SMEs could be explained by the variables under study. From this study it is evident that at 95% confidence level, the variables produce statistically significant values and can be relied on to explain growth in the SMEs sector in Kenya. The government should formulate policies that ensure commercial banks and other financial institutions provide adequate information on the requirements and procedures for applying for a loan. This will enhance efficiency and effectiveness of financial institutions since the borrowers are aware of what is expected. This will enable the owners of SMEs to easily access credit since they are informed of what is expected. The government should try hard to meet the credit needs of the SMEs in the country for a speedy economic growth through creating an enabling environment for financial institutions to thrive. This study focused on SMEs in Nairobi County and therefore the findings of this study cannot be generalized to SMEs outside Nairobi County. The study recommends that further research could be conducted on SMEs countrywide to investigate on the effects of access to credit on financial growth of SMEs to find out whether there are commonalities or unique factors. The study recommends that future research should lay more focus on SMEs in the rural setting in order to find out whether similar relationship exists between access to credit and financial growth in SMEs. This would provide more evidence on the level of access to credit for SMEs in the rural setting and in urban areas then the causes and effects can be documented.
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ACRONYMMS AND ABBREVIATIONS

CBK-Central Bank of Kenya

GDP-Gross Domestic product

GoK-Government of Kenya

MFI-Microfinance institutions

ROS-Return on Sales

ROI-Return on Investment

SME-Small Medium Enterprise

SSB-Small Scale Businesses
CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Broadly speaking, the provision of loans to very small businesses is an increasingly common weapon in the fight to reduce poverty and promote economic growth. The motivation for the continued expansion of microcredit, or at least for the continued flow of subsidies to both nonprofit and for-profit lenders, is the presumption that expanding credit access is a relatively efficient way to fight poverty and promote growth. Yet despite often grand claims about the effects of microcredit on borrowers and their businesses (e.g., the first quote above), there is relatively little convincing evidence in either direction. In theory, expanding credit access may well have null or even negative effects on borrowers. Formal options can crowd-out relatively efficient informal mechanisms (see the second quote above). The often high cost of microcredit means that high returns to capital are required for microcredit to produce improvements in tangible outcomes like household or business income (Braverman and Guasch, 1986).

The accessibility to better financial services is deemed as one of the engines of economic development. The establishment expansion of financial service is also one of the instruments to break the vicious circle of poverty. Governments of less developed countries frequently encourage small scale entrepreneurs by providing cheap credit through financial intermediaries. It is intended that the cheap credit would lower the dependence on the rural money lenders (Pinaki, 1998). The provision
of credit has increasingly been regarded as an important tool for raising the incomes of rural populations, mainly by mobilizing resources for more productive uses. As development takes place, one question that arises is the extent to which credit can be offered to unlock the potential of entrepreneurs who lack access to credit in developing economies to enhance exploitation of available opportunities. However, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans by increasing family income can help the low income earners to accumulate their own capital and invest in income generating activities (Bester, 1985).

Access to credit is a major constraint for small scale entrepreneurs sector and a complicated challenge. Challenges shared by banks and other financial institutions include: the need to open new markets niches in the short or medium term, and transition to the “universal bank” principle, the need to expand credit activity to maintain or increase gross margin, and the need to link the future profitability of the bank with growth of lending to small scale entrepreneurs (Diagne and Zeller, 2001).

1.1.1 Access to Credit

Accessibility to credit is significant for SMEs seeking to grow and expand their businesses. Bank credit usually comes in the form of a small business loan. Businesses often use these lines of credit to expand, explore new areas of their industry, acquire another company, or pay employees. These are essential to the overall success of a business. Lack of access to credit is indicated as a key problem for SMEs worldwide. In some cases, even where credit is available, the entrepreneur may have difficulties because the lending conditions may require collateral for the loan. Credit constraints operate in variety of ways in Kenya where undeveloped capital market forces
entrepreneurs to rely on self-financing or borrowing from friends or relatives. Lack of access to long-term credit for small enterprises forces them to rely on high cost short term finance. For Kenyan SMEs the formal banking system is too expensive and inconvenient (Mokua, 2013).

Lending to small businesses can be seen to be time consuming and costly for banks and other financial intermediaries. Such small firms lack proper accounting procedures and owners easily mix their business and personal finances, making their financial statements often unreliable. This study considers loan applicants whose loans were approved by commercial banks as having access to credit and those whose loan application were rejected are seen not to have access to credit.

Banks consider SMEs with no transaction history are too risky because their ability to repay loans is not yet known. These Unbanked SMEs may also not have collateral to access formal credit. Another issue is that these unbanked SMEs might not have the skills to run the business professionally. They may not have proper bookkeeping procedures, inventory systems, business plans or income statements making it hard for a bank to evaluate them (Frempong, 2007). This hinders growth and expansion of SMEs.

1.1.2 Financial Growth of SME’S

In the developing economies most SMEs have had a tremendous financial growth. This has been fuelled through financial support of MFI. The banking sector has also played an instrumental role in tailoring micro credit schemes in empowering the
SMEs in terms of credit provision. Ease of accessibility to credit have highly contributed to financial growth of SMEs in terms of assets base, level of stocks, service and the number of employees the business can sustain (Mundaca, 2009).

To develop and boosts financial growth the institutional and regulatory preconditions are perhaps the most studied factors underlying a well-functioning financial system. Starting with the seminal contribution of La Porta et al. (1997), many studies have found that financial growth and development is stronger when institutions that protect and match the needs of investors are present. The empirical evidence shows that reinforcing the rights of creditors and contract enforcement tend to deepen financial markets (Levine et al., 2000). The availability of information on borrowers also improves the availability of credit and enhances the efficiency of financial institutions, especially in less developed economies.

An enabling environment for SMEs to grow and expand is significant in facilitating financial growth in terms of assets, products portfolio, and capacity to fund capital investments. Institutional quality, in particular the extent to which institutional checks and balances exist, are also found to be crucial in determining the success of financial reforms and mitigating the likelihood of crises (shows that reinforcing the rights of creditors and contract enforcement tend to deepen financial markets (Levine et al., 2000). External flows, in the form of official aid and portfolio investments, may also be beneficial for credit growth and deposits. This is most likely due to an income effect, whereby capital inflows increase households’ incomes and firms’ earnings, which are then deposited into bank accounts and become available for lending.
To enhance financial growth of MSEs in Kenya, the CBK should also make it a requirement for banks to have a separate micro finance credit line of service to take care of the needs of the SMEs as evidenced by K-Rep Bank, Equity Bank and Family Bank. Creating an enabling policy environment through simplifying and harmonizing licensing requirements, reduction of taxes and enhance access to relevant information through seminars and workshops. The government through the CBK should develop appropriate standards which recognize the special nature of micro finance institutions and strengthen them through integrating their operations in the main stream banking sector.

1.1.3 Access to Credit and Financial Growth of SME’s

The ability to access affordable credit is a critical element to financial growth of SMEs in developing economies. SMEs that often lack the initial capital needed to grow and expand lower their chances of financial growth especially when the owners of these businesses lack collateral to secure loans. This limits growth and expansion of SMEs making it difficult for them to cope and survive in the market. (Braverman & Guasch, 1986).

Visible credit information registries are vital because with credit information sharing, lenders are more aware of borrowers’ capacity and ability to repay their loans, which can significantly decrease default rates, lowering the perceived risk of lending and cost of capital; the registries can also lead to greater inclusiveness of low-income borrowers due to efficiency gains on the part of the lenders via the lowered default rates. Additionally, collateral laws that permit a broad definition of collateral help to eliminate “dead capital,” which can help reduce interest rates and encourage greater
loan volumes (Green and Kimuyu, 2002). This highly contributes to financial growth of SMEs and thus expansion and development especially in developing economies.

Aryeetey (1994) argue that SMEs are particularly important in supporting economic growth and livelihoods in developing countries. There is also a consensus that if all stakeholders are to show serious commitment to the development of the SMEs sub-sector, it follows that the economy must necessarily witness meaningful transformation and prosperity. SMEs are described as efficient prolific job creator, the seed of big businesses and the fuel of national economic engine (Kayanula & Quartey, 2000).

However; this cannot be achieved without removing barriers that hinder entrepreneurs from accessing credit facilities from financial institutions. Despite these contributions of SMEs, their major barriers to financial growth and development appear to be shortage of both equity financing and debt. Thus, according to Lader (1996), one other important problem that SMEs often face is access to capital. Lack of adequate financial resources also places significant constraints on SMEs financial growth and development (Green et al, 2002).

1.1.4 SME’s in Nairobi County

Sometimes called a small business, a small-scale enterprise is a business unit that employs a small number of workers with a low volume of sales. Such enterprises are commonly privately owned and operated sole proprietorships, corporations or partnerships. Small enterprises in Kenya cut across all sectors of the economy and provide one of the main sources of employment and generate widespread economic benefits (GoK, 2005).
According to the Kenya Economic Report, 2009, SMEs Sector accounts for 87 per cent of all new jobs created and absorb about 77 percent of total number of employees in Kenya. The sector generates 18.4 percent of GDP and it is estimated that 74.8 per cent of all businesses in the country fall within SME. In reference to Ocha (2011), in Kenya Micro-enterprises are those that comprise of 10 or less workers while Small enterprises comprise 11-50 workers. The 1999 National Micro and Small Enterprise Baseline Survey define MSEs as enterprises employing 1-50 workers (Republic of Kenya Sessional paper No.2, 2005).

Whilst small scale businesses are a significant part of the business landscape in any county, they are faced by various challenges that compromise their ability to function and to contribute optimally to the economy, especially lack of short, medium and long-term capital inadequate access to financial resources and credit facilities. Lack of access to long-term credit for small enterprises forces them to rely on high cost short term finance. For Kenyan SMEs the formal banking system is too expensive and inconvenient. Whereas banks consider SMEs with no transaction history are too risky because their ability to repay loans is not yet known. These Unbanked SMEs may also not have collateral to access formal credit. Another issue is that these unbanked SMEs might not have the skills to run the business professionally.

Due to their size and resource limitations, owners of small scale business exhibitions face a number of challenges especially in accessing credit to expand and grow their businesses. Despite the great potential and entrepreneurial skills credit as a source of
startup capital is a major problem to most owners of small scale exhibitions and potential entrepreneurs hoping to start up a business.

1.2 Research Problem

The ability to access affordable credit is a critical element of private sector led growth, particularly for small businesses that often lack the initial capital needed to grow and expand and also for agricultural households, where expenditures on inputs precede the returns from harvest; it also increases a business or household’s ability to bear and cope with risk. Entrepreneurs face challenges in accessing credit as a source of capital especially among formal financial institutions; this problem is however created by these institutions mainly through their lending policies (Hubbard, 1995). Access to credit is a major constraint for small scale entrepreneurs sector and a complicated challenge. Challenges shared by banks and other financial institutions include: the need to open new markets niches in the short or medium term, and transition to the “universal bank” principle, the need to expand credit activity to maintain or increase gross margin, and the need to link the future profitability of the bank with growth of lending to small scale entrepreneurs (Diagne and Zeller, 2001).

Weller (2008) looks at financial constraints, the costs of credit and a number of contributions to the costs of credit, including sources and types of loans. The results showed that taste-based discrimination and structural discrimination may have persisted and possibly increased over time. Gaps in credit access and costs of credit have widened by race, remained high by income, but shrank by ethnicity. Part of the overall differences in credit access was a varying reliance on professional information
when making decisions on debt. A study was carried out by Nkuah, Tanye and Gaeten (2013) to examine the challenges and determinants of access to bank credit in Ghana by focusing on SMEs in the Ho Municipality. The study employed the quantitative approach to research in which the probability sampling criteria specifically the stratified and simple random sampling was employed to select eighty entrepreneurs from the municipality. The study found that there exist significantly, positive relations between certain attributes of a firm and access to credits. There are also, some financial activities such as business registration, documentation/recording, business planning, asset ownership, and others that also impact heavily on SMEs access to bank credits. A survey was carried out by Nkeobuna (2012) to evaluate the challenges of bank-credit among SMEs in Nigeria and make recommendations. It was found that it is not easy for SMEs to have access to bank credit in Nigeria.

There has been a tremendous improvement on access to credit as start capital up especially to small and medium entrepreneurs in Kenya. However, most small scale businesses lack adequate funds to grow and expand due to difficulties in accessing credit facilities from financial institutions (Mokua, 2013). Another study by Musa (2012) revealed that credit market participation, access to credit, credit constraint and default are influenced by a number of factors for example; credit market variables, manager’s experience, firm size firm performance indicators and market environment. To establish whether there was any relationship between access to credit and financial growth of SMEs, the researcher reviewed a study on the relationship between access to credit and financial performance of SMEs in Nairobi. In his study, Muguchu (2013) found that there was a positive relationship between access to credit and ROA.
There is limited documented empirical data on the relationship between access to credit and financial growth of SMEs Nairobi County. A knowledge gap exists, and therefore, this study attempts to answer the following research question: what is the relationship between access to credit and financial growth of SMEs in Nairobi County?

1.3 Objective of the Study

To establish the relationship between access to credit and financial growth of SMEs in Nairobi county.

1.4 Value of the Study

The findings will be useful in providing important information on how SMEs can utilize credit to growth and expand their businesses. Financial institutions can also use this study to come up with terms and conditions on easing access to credit to potential entrepreneurs as well as providing financial advice on better methods of investing capital in their small scale exhibition to boost growth and expansion.

The findings will aid the government in policy formulation and models that would stimulate increased lending by financial institutions to small scale entrepreneurs to enhance access to credit as source of capital to start and grow SMEs in Kenya. Researchers and academicians can also use this study to build on the existing literature on effective ways of credit utilization to boost small scale businesses. The findings of this study will be used as source of reference besides it can be used as a basis for further research to those interested in this area of study.
The findings of this study will be helpful to commercial banks since they can negotiate with the central bank to lower interest rates in order to increase access of credit and facilitate growth of small and medium businesses as well as providing financial advice on viable investment projects.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter presents a review of literature that is related to the study. The chapter also describes the theoretical and empirical review of the research project.

2.2 Theoretical Review

The study is informed from by the credit rationing theory, credit channel theory and rural credit theory and other relevant theoretical literature which suggest that policy may have an effect on credit supply and demand in an economy.

2.2.1 The Credit Rationing Theory and Access to Finance

The credit rationing theory, propounded by Stiglitz and Weiss (1981), provides a framework for analyzing financial market inefficiencies. It asserts that, information asymmetry is the main cause of financial market malfunctioning in developing countries. Banks that advance loans to economic agents are not only interested in the interest they receive on loans, but also the risks of such loans. Also, the interest banks charge on loans have the tendency to affect the risks of a pool of loans by either sorting potential borrowers (the adverse selection effect) or affecting the behavior of borrowers (the moral hazard problem).

The end result of these two decisive problems are that banks have to resort to various screening means to identify potential borrowers who are more likely to pay back their loans; since the expected return on such loans depends crucially on the probability of
restitution. One of the methods of screening suggested by Stiglitz and Weiss is the interest rate that an individual is willing to pay. This is because, given the efficient financial markets hypothesis, individuals who are willing to pay high interest rates may on the average not pay back the loans collected and banks are mostly discouraged to give loans to such borrowers (Diagne, and Zeller, 2001).

On the other hand, low risk borrowers, faced with high interest rates, all other things being equal will be expecting negative returns and hence will not go for such loans. control such actions. The terms of loan contract are thus designed (by banks) in a manner that induces borrowers to take actions in the interest of banks, and that also attracts low risk borrowers. For both reasons, the expected returns of banks increase less rapidly than the interest rate and beyond a certain point, actually declines. The moral hazard problem, on the other hand, is that a risk-neutral firm will prefer projects with low probability of bankruptcy and hence make lower expected returns.

Stiglitz and Weiss (1981) further argued that the problem of adverse selection and credit rationing can again occur if banks require collateral for loans. They argue that since low-risk borrowers (borrowers who face a lower rate of return if a project returns its highest outcome) expect a lower rate of return if the rate of inflation is high, they are on the average less wealthy than high-risk borrowers (after some time period) and even, are unable to provide more collateral for extra loans (as they may not have the necessary collateral). The most important conclusion from Stiglitz and Weiss argument is that information asymmetry in the form of adverse selection and moral hazard is the source of market inefficiency in developing countries and this leads to low risk borrowers such as SMEs being sidelined or even excluded from the stream of potential borrowers.
2.2.2 Credit Channel Theory

Diagne and Zeller (2003) noted that the recently advanced "credit channel view" implies that monetary policy shocks affect real economic performance through the supply of credit by financial intermediaries due to shifts in the supply schedule of the latter. In turn, they noted, the literature makes a distinction between a "bank lending channel" which pertains to banks only and is related to their dual nature of holders of deposits and generators of loans to firms and a "broad credit channel" which treats the supply of external funds to firms by all financial intermediaries. The credit channel view is also consistent with the assumption of the existence of market imperfections, in particular, information asymmetries between borrowers and lenders which give rise to the above mentioned monitoring cost premium (Hubbard, 1995).

One implication of the existence of a credit channel in the monetary transmission mechanism is that it induces a heterogeneous response both of the credit market and of the firms due to which the increase in the cost premium for external finance will not be uniformly distributed across firms. The reason for this heterogeneity is the fact that the existing credit market imperfections are likely to impact in a different manner on various categories of firms in the event of a monetary shock (Bester, 1985). In particular the credit channel view is consistent with the empirical finding that the effect of a monetary shock should be more severe for small firms (that are more likely to face information costs) than for large firms or that the effects of a monetary contraction on investment is greater for highly leveraged firms (which are more likely to suffer a reduction in their collateralizable net worth due to the monetary shock) than for less leveraged firm. It is worth noting that the Kenyan agricultural sector is largely dominated by small scale firms and going by the foregoing empirical finings it would
not be out of place to expect monetary policies having some effects on their
collateralizable net worth and hence their credit requirements which banks tend to
respond to when they supply credit (Pinaki, 1998).

The indicators of financial development which can influence credit supply used in
empirical studies can be classified roughly intro three broad categories; monetary
aggregates, stock market indicators, structural and institutional indicators. The
disaggregated variables for financial variables used in the empirical model represent
the monetary aggregates and stock market indicators (Liedholm, Mead and Donald,
1999). All had direct and positive effects on bank lending to agriculture except value
traded ratio which had a direct but negative effect. According to Rajiv and Atreya
(2002) the effects of monetary policy on real activity are felt through the demand for
money and the (unique) interest rate. In reality, shocks in monetary policy will affect
the relative structure of interest rates. In reality, shocks in monetary policy will affect
the relative structure of interest rates given imperfect substitution among financial
instruments.

Soyibo and Adekanye (1992) stressed the special influence of financial reforms on the
financial sector and he exemplified the influence by the proxy of exchange rate and
interest rate which were acknowledged as the drivers of growth of real sectors of the
economy including small scale business. From the foregoing analysis we arrive at the
choice of some variables as proxies for small scale lending and its banking sector and
monetary policy variables determinants. Three models that can be used to capture the
relationship suggested by the foregoing credit supply theories are linear multiple
regression function, growt-h model (Semi-log model) and Cobb Dounglas (Double
log) function (Yadav, Otsuka and David, 1992). These are various growth functions. Linear regression attempts to model the relationship between two or more variables by fitting a linear equation to observed data. One variable (or set of variables as in multiple linear regression) is considered to be an explanatory variable, and other is considered to be a dependent variable. For example, modeler might want to relate the weights of individuals to their heights using a linear regression model.

2.2.3 Crucial Role of Access to Finance Theory

Modern development theory studies the evolution of growth, relative income inequalities, and their persistence in unified models. In many of these models, financial market imperfections play a central role, influencing key decisions regarding human and physical capital accumulation and occupational choices. For example, in theories stressing capital accumulation, financial market imperfections determine the extent to which the poor can borrow to invest in schooling or physical capital. In theories stressing entrepreneurship, financial market imperfections determine the extent to which talented but poor individuals can raise external funds to initiate projects. Thus, the evolution of financial development, growth, and intergenerational income dynamics are closely intertwined. Finance influences not only the efficiency of resource allocation throughout the economy but also the comparative economic opportunities of individuals from relatively rich or poor households (Demirguc-Kunt et al, 2013).

This crucial focus on the financial sector in economic modeling has been strengthened with the historical development of views on the links between economic growth and
income inequality. It was long believed that the early stages of economic development would inevitably be accompanied by inequality and concentrations of wealth. Pointing to the fact that rich people’s marginal propensity to save is higher than that of the poor; theoreticians argued that the need to finance large, indivisible investment projects in the process of development implied that rapid growth would need wealth concentration, leading to a fundamental trade-off between growth and social justice (Kuznets, 1955).

More generally, Kuznets (1955) reasoned that this trade-off meant that inequality would increase in the early stages of development until the benefits of growth spread throughout the economy. Some of the earlier empirical evidence from the United States and other developed countries supported the Kuznets hypothesis. But evidence from developing countries was not so supportive. The importance of providing incentives to reward the productive efficiency of enterprise and investment might seem to imply that growth and inequality must be positively linked, but empirical studies suggest that this is not always so. In particular, while very low inequality is indeed empirically associated with rapid subsequent growth, the highest rates of growth are associated with moderate inequality. Furthermore, high levels of inequality seem to reduce subsequent growth. Helping to explain these findings, more subtle theories have explored precise mechanisms whereby inequality might adversely affect growth. Financial market imperfections are often at the core of this line of thought because inequalities persist because of this imperfections. For example, in the model of Galor and Zeira (1993), it is because of financial market frictions that poor people cannot invest in their education despite their high marginal productivity of
investment. In Banerjee and Newman’s model (1993), individuals’ occupational choices are limited by their initial endowments.

The structure of occupational choices whether people can become entrepreneurs or have to remain wage earners in turn determines how much they can save and what risks they can bear, with long-run implications for growth and income distribution. Hence, these models show that lack of access to finance can be the critical mechanism for generating persistent income inequality or poverty traps, as well as lower growth. One implication of these modern development theories is that redistribution of wealth can foster growth. Indeed, this has been the main policy conclusion drawn by many readers of these theories (Galor & Zeira, 2012).

This thinking rationalizes a focus on redistributive public policies such as land or education reform. However, if it is the capital market imperfections that lead to these relationships and necessitate redistribution, why neglect policies that might remove capital market imperfections. Nevertheless, some theories take credit constraints or other frictions as exogenous. In others, static information and transaction costs endogenously yield adverse selection and moral hazard frictions that impede the operation of financial markets. In either case, researchers take capital market imperfections as given and suggest different redistributive policies to promote growth, focusing on schooling, saving, or fertility changes. This is true even though the literature also notes that if financial market imperfections continue to exist, absence of a virtuous circle a la Kuznets may also necessitate permanent redistribution policies (Banerjee et al, 1991).
A more effective and sustainable development approach would directly address financial market imperfections, without causing adverse incentive effects. Most redistributive policies create disincentives to work and save, although the economic magnitudes of these disincentive effects are a subject of intense debate (Aghion and Bolton 1997). As Demirgüç-Kunt and Levine (2007) argue, these tensions vanish when focusing on financial sector reforms. Reducing financial market imperfections to expand individual opportunities creates positive, not negative, incentive effects. Hence these arguments are very consistent with modern development theories yet emphasize putting financial sector reforms that promote financial inclusion at the core of the development agenda. Addressing financial sector imperfections can also appeal to a wider range of philosophical perspectives than can redistributive policies in as much as the latter are directly linked with equalizing outcomes, whereas better functioning financial systems serve to equalize opportunities.

Anand & Kanbur (1993) extensive empirical evidence suggests a significant and robust relationship between financial depth and financial growth. More recent micro evidence using firm-level data sets suggests that better-developed financial systems ease financial constraints facing firms. This finding illuminates one mechanism through which financial development influences economic growth. Furthermore, researchers recently have shown that financial depth reduces income inequality and poverty and is thus particularly beneficial for the poor.

Although these results are encouraging, the link between theoretical models and empirical evidence has not been very close because of a lack of data on access to
financial services. While theory focuses on the importance of broader access and greater opportunities (that is, financial inclusion), relatively little empirical evidence links access to finance to development outcomes, and there is little guidance for policies on how best to promote access (Demirguc-Kunt et al, 2013).

Financial depth or development more generally, can have direct and indirect effects on small firms and poor households. Greater depth is likely to be associated with greater access for both firms and households, which will make them, better able to take advantage of investment opportunities, smooth their consumption, and insure themselves. However, even if financial development does not improve direct access for small firms or poor households, its indirect effects may also be significant (Barro, 2000).

2.3 Determinants of Growth

The growth of a firm in any given period of time is independent of the size of the firm at the beginning of the period. A broader analysis of other factors affecting firms’ growth empirically or theoretically has been less common. Even considering that several factors such as size and age of the firm, financial resources and technology level have been evaluated in previous studies, none of them has considered measures of financial resources and technology together. Despite these important effects of financial constraints on firm growth, few studies have included measures of financial resources on empirical research of firm growth.
Becchetti and Trovato (2002) tested the effect of two financial variables on growth. The first one was the leverage ratio of the firm and the second one was a qualitative dummy variable that defined whether the firm had a loan request rejected by a bank or not. While the effect of the leverage ratio was found not significant, the qualitative dummy variable proved to be an important restraint on growth. Instead of availability of external sources of financing Chen et al. (1985) used profitability of the firm as a proxy of financial resources of the firm to boost growth.

Profits play a dominant role in the capacity to access financial resources since it is simultaneously a source of internal financing and a hook to attract external sources of financing. Commercial banks, venture capitalists, investment banks, pension funds and other investors base their decisions on present and expected future values of profits or improved technology allows the firm to produce with a more efficient bundle of resources that reduces cost, and or allows the creation of improved products or even completely new products. Such firm will be more likely to be in a position to surpass competition, reach new markets and expand.

Variyan and Kraybill (1994), in a study of firms in Southern United States, found that the majority of managers of firms analyzed considered the use of technology as a critical element of their competitive advantages. Those firms, which placed more emphasis in the use of new technology, had higher growth rates than firms that did not view technology as a critical factor. Additionally, in a cross sectional analysis of industries, Birley and Westhead (1990) encountered evidence supporting the hypothesis that firms with newer technology in the major manufacturing lines were associated with higher levels of growth and performance.
The effect of initial size was tested on firm growth. The hypothesis tested here and in several previous researches is if size, as a measure of the amount of resources of the firm, has any influence on the growth performance of firms. To be consistent with the growth measure chosen, initial size (size) is measured as the amount of sales at the beginning of the period in 1994. If Gibrat’s law holds, then the coefficient for size should be non-significant. Conversely, if Gibrat’s law does not hold, as indicated by most recent findings, we will expect a negative and significant coefficient for the size variable. Profit in terms of return on sales was obtained from the National Economic Census of 1993 and 1994. Then the average return on sales for the two years previous to the growth period analyzed, 1992-93, (ROS) was included as an explanatory variable of growth rates in the period 1994-96. A positive and significant relation is expected for this variable.

2.4 Empirical Review

A study was conducted in Croatia by Kundid (2007) on Empirical analysis of credit rationing in the corporate bank loan market was carried out on a sample from the Croatian financial market which included data on approximately 4,300 small, medium-sized and large companies in the period from the end of 2008 to the first quarter of 2010. The study established that access to credit had a positive impact on growth of SMEs. A study conducted by Aruwa (2002) on various financing options for small and medium enterprises in Nigeria, a random sample of 10 formal and informal finance sources and 20 SMEs in 6 selected small and Medium industries in Kaduna and Abuja, It was found that financing options for SMEs are numerous but
access to these funds has been difficult inspite of several government initiatives. The study concluded that adequate capital and credit have remained a key success factor for SMEs.

A survey was carried out in Ghana by Ahiawodzi (2012), on effect of access to credit on the growth of Small and Medium Scale Enterprises (SMEs) in the Ho Municipality of Volta Region of Ghana by using both survey and econometric methods. The survey involved a sample of 78 SMEs in the manufacturing sector from the Ho Municipality. Both survey and econometric results show that access to credit exerts a significant positive effect on growth of SMEs in the Ho-Municipality of Ghana- the main policy implication of the study therefore is that the government should try hard to meet the credit needs of the SMEs in the country for a speedy economic growth.

In their study, Nkuah, Tanye and Gaeten (2013) examined the challenges and determinants of access to bank credit in Ghana by focusing on SMEs in the Wa Municipality. The study employed the quantitative approach to research in which the probability sampling criteria specifically the stratified and simple random sampling was employed to select 80 entrepreneurs from the municipality. The study found that there exist significantly, positive relations between certain attributes of a firm and access to credits. There are also, some financial activities such as business registration, documentation/recording, business planning, asset ownership, and others that also impact heavily on SMEs access to bank credits. A survey was carried out by Nkeobuna (2012) to evaluate the challenges of bank-credit among SMEs in Nigeria and make recommendations. It was found that it is not easy for SMEs to have access to bank credit in Nigeria.
Mokua (2013) conducted an investigation on the extent to which collateral measures influence credit financing of small business enterprises in Kisii Town and to ascertain the extent to which management skills influence credit financing of small scale business enterprises in Kisii Town. The study employed the descriptive survey research design and employed questionnaire to collect data from 160 SSB in Kisii town. The researcher sampled 160 SSB out of the population of 560 SSB using a simple stratified sampling technique. The study found out that the enterprises had inadequate funds. It was also revealed that the enterprises had stagnated in their financial status due to corruption in the municipality. It was also revealed that the enterprises had inadequate finances due to procedures that are too long to get the funding from financial institutions. The financial status of the enterprises is therefore affected in one way or the other.

A study by Makena (2012) was intended to identify the challenges faced by SMEs in accessing finance in Kiambu Town. The findings indicated that problems faced by SMEs were insufficient collateral (71.4%) and Business proposal not acceptable (21.4%). On the same note the study identified that the most challenging stage of the loan process were; application and appraisal stage, loan approval stage and the period it took to process the loan. Terms of coping mechanism used to manage challenges faced by SMEs in accessing finance, the study identified the following; saving and trying to reduce expenses, attending financial seminars, use of merry go rounds, borrowing from friends at zero interest rates, reducing credit period for the firm’s creditors, obtaining credit facilities from suppliers, ploughing back profits, offering stock as security, consulting with other SMEs owners, joining Sacco, using credit cards and overdrafts.
A survey was conducted by Musa (2012) the thesis focuses on post-war period, looking at credit market participation; credit constraint and credit default in order to facilitate holistic integration of small enterprises in credit programs of Liberia. The thesis contributes to literature by providing support to existing theories and presenting new evidence on the contextual nature of interaction between small firms and credit market in a post-war economy. Micro-econometric models and firm level data gathered from surveying of small-scale firms using the Liberia National Account of the Establishment Survey were used for analysis. The key findings indicate that credit market participation, access to credit, credit constraint and default are influenced by a diversity of factors such as credit market variables, skill/experience of managers, firm size, firm performance indicators and market environment that defines firm operations.

In his study about the impact of micro-finance credit on the financial performance of SMEs in Kenya, Kanyugi (2011) found out that as SMEs grow they require funds to finance growth in fixed asset and increase working capital. SMEs therefore require long-term credit in ever increasing amounts so that they can purchase raw materials, supplies and carry out activities that they need to facilitate the production process. This study applied descriptive statistics on net profit indicating that the net profit after access of credit from MFIs was more than the net profit before access of credit. This was attributed to the increased working capital of the SMEs and expansion of business operations. From the study findings it was concluded that, access of credit by SMEs from MFIs greatly influences their performance.
Barasa (2013), sought to determine the rate of interest charged by financial institutions, types of products and to evaluate how competition among lending institutions have influenced availability of credit to the SMEs. The study adopted a survey study design to obtain cross-sectional data from financial institutions and SMEs in Nakuru town. A sample of 30 financial institutions and 50 SMEs were selected using stratified random sampling technique to obtain a representative sample. The study found that MFIs and SACCOs to be the main sources of credit for SMEs. It also found that access to long term credit in banks is still very low. Overall, study findings revealed a positive significant correlation between recent competition in financial market of Kenya and access to credit in SMEs.

To establish whether any relationship exists between access to credit and financial performance of SMEs in Nairobi County, a study by Muguchu (2013) was examined determine. The study employed descriptive analysis as well as regression analysis to analyze the data collected. The target population under study was the licensed SMEs by Nairobi City Council in 2013. Of the licensed SMEs in Kenya, an estimated 50,000 licensed SMEs are located in Nairobi. Cluster sampling of SMEs in the central business district in Nairobi was done by clustering the SMES based on the streets where they are located. A sample of 40 SMEs within the central business district was selected for the survey. Descriptive analysis as well as regression analysis found that there was a positive relationship between access to credit and ROA.

2.5 Summary of Literature Review

The literature review expounded above generally indicates that access to credit highly limits growth of SMEs. From literature review, it is evident that restrictive credit
requirements and guidelines in regulatory systems inhibit access to credit by borrowers. This is a constraint to financial growth of SMEs. The research attempts to fill gaps identified due to hindrances that prevent borrowers from accessing credit from commercial banks and other financial institutions. The gaps require that the central bank of Kenya should come up with clear policies that encourage borrowers to borrow money from commercial banks without barriers to invest in SMEs for example: reducing interest rates and advisory services on how to apply loans and the requirements needed to access credit facilities. Since access to credit directly impacts on financial growth of SMEs, owners of these businesses will be able to grow and improve productivity of these SMEs.
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the procedures used by the researcher to collect and analyze data collected from the field in the study. It covers the following areas: Research design, target population, sampling procedure, data collection instruments, data analysis tests of significance.

3.2 Research Design

The study used descriptive survey design. A descriptive survey design is appropriate for this study since the study will focus on more than one SME. Research design refers to how data collection and analysis are structured in order to meet the research objectives through empirical evidence (Cooper & Schindler, 2006).

3.3 Population

The population of this study was SMEs registered in Nairobi County registered under the register of companies that would be in various strata: financial services, trade and commercial services with specific attention to the owners and staff of these SMEs. The population of SMEs according to (NCC, 2013) is at 52,654. Cooper and Schindler (2001) defined a population as the total collection of elements which the researcher wishes to make inferences.
3.4 Sample

The researcher did cluster sampling of 40 small and medium enterprises in Nairobi based on geographical locations. Four main streets namely: Moi Avenue, Kenyatta Avenue, River Road and Tom Mboya Road will be selected. SMEs on these streets were counted using a sampling frame. This was followed by a random selection of 10 SMEs from each street using random sampling. Caution was taken to ensure that a proportional representation from each cluster was taken. The cluster sampling method is helpful in minimizing the costs and time. Kombo and Tromp (2006) recommendation that a sample size of 10% to 30% is a sufficient representation of the whole population.

3.5 Data Collection Method

The study used secondary sources of data. Secondary data was sourced from the financial records of the SMEs from year 2009 to 2013. Other sources of secondary data included relevant literature and records from the library. Electronic database provided access to relevant journals and publications related to the topic. The study used three independent variables: Access to credit was measured through checking the loan book records from SMEs, asset turnover was measured using sales revenue divided total assets while the size of the SMEs was measured using the return on sales which is net income divided by sales. The dependent variable was financial growth which was measured using the increase in net assets.
3.6 Data Analysis

Data collected was purely quantitative and was analyzed using descriptive analysis. A regression analysis was used to come up with the model. The study used a simple regression equation. The dependent variable used was financial growth of SMEs which was measured using increase in total assets. The independent variables were access to credit which will be measured through checking the loan book records from SMEs, asset turnover was measured using sales revenue divided total assets while the size of the SMEs was measured using the return on sales which is net income divided by sales. This study adopted multiple regression model as illustrated below:

3.6.1. The Analytical Model

The study used simple regression model of equation to establish the relationship between access to credit and financial growth of SMEs in Nairobi County. The researcher used a five year period trend. The researcher sought to extend the model as advanced by Kiprop in the year 2013.

\[ Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon \]

Financial growth of SMEs was measured by increase in total assets. The researcher determined the percent change of financial growth using a five year period.

Where: \( Y \) is the dependent variable which represented financial growth of SMEs measured by percentage increase in total assets.
$X_1 =$ Access to credit was measured through checking the loan book records from SMEs. Balance sheet and profit and loss statement were used for this purpose.

$X_2 =$ Asset Turnover was measured using sales revenue divided total assets

$X_3 =$ Size of the firm was measured using return on sales which is net income divided by sales.

a, and b = regression constants

e is the error term

3.6.2 Diagnostic Tests

3.6.2.1. T-test

A t-statistic test will be used to determine the significance of the independent variables in influencing financial growth of SMEs. T-test will be used to test the hypothesis that a particular coefficient is significantly different from zero or whether the estimated coefficient value occurred by chance in equation. The tests will be performed at both 95% and 99% levels of confidence.

3.6.2.2. F-test

The F-statistic is important to test the hypothesis that the whole relationship provided by the equation above is significantly different from zero, i.e. whether the independent variables’ characteristics scores explain the variation in financial growth indicators for each of the individual firms. The test will be performed at both 95% and 99% levels of confidence.
3.6.2.3. R² - Change

The R-squared (R²) value ranging from 0 to 1 or the corrected R-squared (R²), which is adjusted for degrees of freedom indicates the explanatory power (goodness of fit) of the model.
CHAPTER FOUR

DATA ANALYSIS RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research objective and research methodology. The study findings are presented on the relationship between access to credit and financial growth of SMEs in Nairobi County of SMEs in Nairobi County. The study used secondary data from financial statements.

4.2 Response Rate

The study was carried out to establish the relationship between access to credit and financial growth of SMEs in Nairobi County. A total of 40 SMEs, 10 each from the four main streets in Nairobi Central Business District namely: Moi Avenue, Kenyatta Avenue, River Road and Tom Mboya Street were selected for analysis in this study. Data from 29 of the SMEs was collected representing 72.5% response rate. From the secondary data collected, 18.38% was collected from Moi Avenue Street, 17.36% were from Kenyatta Avenue, 20.42% were from River Road and 16.33% from Tom Mboya Street.

4.3 Descriptive Statistics

The study used descriptive statistics to summarize the sample of the population studied. This data is however a representative of the whole population. Below are the results of the descriptive statistics as provided below:
4.3.1 Net Assets

The study sought to determine the trend in growth of assets for SMEs in a period of five years. This was intended to establish the effect of access to credit on financial growth of SMEs in Nairobi County. The findings are presented below:

Figure 4.1

Source: Research Findings

From the findings in figure 4.1 above, there was a rapid increase in net assets from year 2009 to 2011, in between the year 2010 and 2011 this was followed by a steady increase in net assets up to the end of 2011. At the start of year 2012 a rapid increase in net assets followed up to the end of the year 2013. This increase can be explained by access to credit by SMEs. The steady growth could have been as a result of the time before SMEs accessed credit.
4.3.2 Effect of Access to Credit on Financial Growth of SME’s

The study examined the level of access to credit by SME’s within a period of five years with the objective of determining the effect of access to credit on financial growth of SME’s in Nairobi County. Below are the results of the findings:

**Figure 4.2**

![Bar chart showing access to credit from 2009 to 2013](chart.png)

Source: Research Findings

From the above findings in figure 4.2, the findings revealed that between years 2009/2011 there was a rapid increase in the level of access to credit by SME’s. This was followed by a slight decline in the year 2012 which was then followed by a significant increase in the amount of access to credit by SME’s in the year 2013. The decline in the year 2012 could have been as a result of the increase in interest and other macro-economic factors that affected the performance financial institutions.
This in turn discouraged owners and managers of SMEs from borrowing credit from financial institutions leading to a decline in financial growth of SMEs.

4.3.3 Sales

The researcher sought to determine the amount sales by SMEs in Nairobi in a period of five years with the objective of establishing whether the increase in the amount of sales contributed to financial growth of SMEs. Below are the results of the findings

**Figure 4.3**

![Sales Graph](image)

Source: Research Findings

From the above figure 4.3 above, it was revealed that in the year 2009 and 2010 there was a steady increase in sales, the was followed by a significant decline in year 2011 that negatively impacted on the financial growth of SMEs in Nairobi County. In
between 2011 and 2012 there was a rapid increase in the amount of sale by SMEs which progressively continued towards the year 2013.

4.4 Regression Analysis

In order to establish the relationship between independent and dependent variables, a simple regression was conducted. The analysis applied the statistical package for social sciences (SPSS) to compute the measurements of the multiple regressions for the study. The findings were as shown in the table 4.1 below. The research study aimed at evaluating the relationship between access to credit and financial growth of SMEs in Nairobi County. The study findings found that there was a positive relationship (R= 0.986) between the variables. The study also revealed that 97.3% of financial growth in the SMEs could be explained by the variables under study. From this study it is evident that at 95% confidence level, the variables produce statistically significant values and can be relied on to explain growth in the SMEs sector in Kenya

Table 4.1: Model Summary

<table>
<thead>
<tr>
<th>Model Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
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<tr>
<td>-------</td>
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<tr>
<td>1</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Access to credit  (Million Kenya shillings)

In order to explain the percentage of variation in the dependent variable (Access to credit) that is explained by the independent variable (Access to credit asset turnover
and size), the researcher used coefficient of determination obtained from the model summary in table 4.1. Coefficient of determination explains the extent to which changes in the dependent variable (Access to credit) can be explained by the change in the independent variable or the percentage of variation in the dependent variable that is explained by the variable (Access to credit). From the analysis, the independent variable Access to credit in this study contributed to 98.3% of the variation in financial growth of SMEs in Nairobi County of SMEs as explained by adjusted R2 of 0.983.

The study conducted an Analysis of Variance, in order to test the significance of the model. The findings were as shown below:

**Table 4.2: ANOVA**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>2.703</td>
<td>3</td>
<td>0.901</td>
<td>4.7672</td>
<td>.000a</td>
</tr>
<tr>
<td>Residual</td>
<td>5.122</td>
<td>27</td>
<td>0.189</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>7.825</td>
<td>30</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Access to credit, Asset Turnover, Size
b. Dependent Variable: Financial growth of SMEs (Million Kenya Shillings)

**Author: Research data (2014)**

From the ANOVAs results, the probability value of 0.000 was obtained implying that the regression model was significant in predicting the relationship between access to
credit and financial growth of SMEs in Nairobi County of SMEs and the predictor variables as it was less than \( \alpha = 0.05 \). By use of the F-table, the \( F(5\%, 1, 2) \) tabulated was 4.7571 which was less than \( F = 4.7672 \) as well indicated that the model was significant.

**Table 4.3: Coefficients**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>0.621</td>
<td>1.063</td>
<td>3.730</td>
<td>.000</td>
</tr>
<tr>
<td>Access to Credit</td>
<td>1.013</td>
<td>.125</td>
<td>.702</td>
<td>1.201</td>
</tr>
<tr>
<td>Asset Turnover</td>
<td>.056</td>
<td>.432</td>
<td>.501</td>
<td>.401</td>
</tr>
<tr>
<td>Size</td>
<td>.112</td>
<td>.411</td>
<td>.001</td>
<td>.077</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Financial Growth (Million Kenya Shillings)

**Author: Research data (2014)**

The researcher conducted a simple regression analysis so as to determine the relationship between financial growth of SMEs in Nairobi County (dependent variable) and access to credit by SMEs in Nairobi. The following regression equation was obtained:

\[
\text{Net Assets} = 0.621 + 1.013X_1 + 0.56X_2 + 1.12X_3
\]

From the regression model obtained above, holding all the other factors constant, financial growth of SMEs in Nairobi County of SME measures would be 0.621. A unit change in access to credit holding the other factors constant will lead to change in
financial growth of SMEs in Nairobi County of SMEs by 1.013. Similarly a unit change in asset turnover holding all factors constant will lead to change in financial growth of SMEs by 0.56 while size will lead to change in financial growth by 0.112. This implies that access to credit has a significant influence on financial growth of SMEs in Nairobi County of SMEs in respect to the current financial growth of SMEs in Nairobi County of SMEs and the accessibility of credit to the owners and managers of SMEs.

The obtained regression equation further implied that there was a direct relationship between access to credit and financial growth of SMEs in Nairobi County of SMEs. The analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the corresponding probability value obtained and \( \alpha = 0.05 \). If the probability value was less than \( \alpha \), then the predictor variable was significant otherwise it wasn’t. Therefore, Access to credit was significant in the model as its corresponding predictor variables was 0.017.

### 4.5 Summary and Interpretation of Findings

Provision of credit to SMEs is still a fundamental problem faced by most owners and managers of SMEs since most of them lack security or collateral to be able to access credit facilities. The findings of the study also revealed that a few owners of SMEs that obtained credit were able to grow and expand their businesses significantly. These findings are consistent with previous studies that have been conducted in relation to the effect of access to credit on financial growth of SMEs. In a survey was carried out by Nkeobuna (2012) to evaluate the challenges of bank-credit among
SMEs in Nigeria and make recommendations. It was found that it is not easy for SMEs to have access to bank credit in Nigeria this negatively impacted on financial growth of SMEs in Nigeria. This is evident that access to credit highly contributes to financial performance of SMEs.

With regard to the regression results, it was observed that there was a positive relationship (R= .986) between the access to credit and financial growth of SMEs in Nairobi County. This is supported by a survey carried out in Ghana by Ahiawodzi (2012), on effect of access to credit on the growth of Small and Medium Scale Enterprises (SMEs) in the Ho Municipality of Volta Region of Ghana by using both survey and econometric methods. The study employed the quantitative approach to research in which the probability sampling criteria specifically the stratified and simple random sampling was employed to select 80 entrepreneurs from the municipality. The study found that there exist significantly, positive relations between certain attributes of a firm and access to credits.

Other studies that are consistent with the above findings include: a study by Kanyugi (2011) found out that as SMEs grow they require funds to finance growth in fixed asset and increase working capital. This study applied descriptive statistics on net profit indicating that the net profit after access of credit from MFIs was more than the net profit before access of credit. This was attributed to the increased working capital of the SMEs and expansion of business operations. From the study findings it was concluded that, access of credit by SMEs from MFIs greatly influences their performance. Also, a study by Barasa (2013), sought to determine the rate of interest charged by financial institutions, types of products and to evaluate how competition
among lending institutions have influenced availability of credit to the SMEs. It also found that access to long term credit in banks is still very low. Overall, study findings revealed a positive significant correlation between recent competition in financial market of Kenya and access to credit in SMEs.
CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATION

5.1 Introduction

This section covers the summary of the findings, conclusions, limitations of the study, recommendations, policy recommendations and suggestions for further study.

5.2 Summary of the Findings and Discussions

This study was carried out to establish the relationship between access to credit and financial growth of SMEs in Nairobi County, by carrying out a descriptive survey of SMEs in Nairobi County; the researcher used a systematic sampling technique to collect secondary data from SMEs in Kenyatta Avenue, Moi Avenue, River Road and Tom Mboya Street. The study’s objective is to establish the relationship between Access to credit and financial growth of SMEs in Nairobi County in Kenya.

The findings of the study revealed that a few owners of SMEs that obtained credit were able to grow and expand their businesses significantly. The study findings found that there was a positive relationship ($R=0.986$) between the variables. The study also revealed that 97.3% of financial growth in the SMEs could be explained by the variables under study. From this study it is evident that at 95% confidence level, the variables produce statistically significant values and can be relied on to explain growth in the SMEs sector in Kenya. The government should formulate policies that ensure commercial banks and other financial institutions provide adequate
information on the requirements and procedures for applying for a loan. This will enhance efficiency and effectiveness of financial institutions since the borrowers are aware of what is expected. This will enable the owners of SMEs to easily access credit since they are informed of what is expected. The government should try hard to meet the credit needs of the SMEs in the country for a speedy economic growth through creating an enabling environment for financial institutions to thrive. This study focused on SMEs in Nairobi County and therefore the findings of this study cannot be generalized to SMEs outside Nairobi County. The study recommends that further research could be conducted on SMEs countrywide to investigate on the effects of access to credit on financial growth of SMEs to find out whether there are commonalities or unique factors. The study recommends that future research should lay more focus on SMEs in the rural setting in order to find out whether similar relationship exists between access to credit and financial growth in SMEs. This would provide more evidence on the level of access to credit for SMEs in the rural setting and in urban areas then the causes and effects can be documented.

5.3 Conclusions

The study concludes that access of SMEs leads to financial growth of SMEs. This conclusion is supported by the study findings which showed that there was a very strong positive relationship (R= 0.981) between the variables. This findings are consistent to a similar study by Muguchu, M.(2013), who established a positive relationship (R= 0.765) between access to credit and financial performance of small and medium enterprises in Nairobi and Ahiawodzi, K. (2012), who established positive relationship between Access to Credit and Growth of Small and Medium Scale Enterprises in the Ho Municipality of Ghana.
As a result of access to credit businesses grow this is achieved through increased sales, assets, size of the business, number of employees and financial stability. As a result of increased access to credit, the results of findings show that there was an increase in financial growth of SMEs this is attributable to an increase in working capital. There is a significant increase in the total asset base attributable to increased purchasing power. Access to credit creates opportunity for growth and expansion of SMEs and this helps in creating employment leading to economic growth. These conclusions are supported by descriptive statistics.

5.4 Limitations of the Study

The limitation of this study is that it is utilized secondary data, which had already been obtained and in the public domain. Unlike the primary data which is first-hand information, despite that the secondary data was tested for precision and remained relevant since it reflected current macroeconomic conditions and financial soundness in the republic of Kenya.

The study adopted a multiple regression model with four variables: three independent variables (access to credit, asset turnover and size) and one dependent variable (financial growth). Future researchers can adopt a similar model but investigate on other variables that may have an effect on financial growth of SMEs. Results and findings can be made and conclusions drawn.

The study adopted was conducted in a period of five years between (2009-2013) these findings may not hold in the next five years due to the dynamic nature of the business environment for example change of regulations, policies and procedures. This change could also be affected by technology among other macroeconomic factors. It is
therefore necessary for a study to be conducted on the same topic after five years then fining can be compared and conclusions drawn.

Most of the financial statements are reaffirmed in the preceding years meaning that material misstatements of firms\’ performance can create a window of opportunity for prior year\’s adjustments and this may not be brought to the attention of the public. This means the pattern depicted may affect the relationship established.

This study was carried out within a limited time frame and resources which constrained the scope and depth of the study. This necessitated the adoption of a sample design hence these findings cannot be used to make generalizations on the effect of access to credit and financial growth of SME\'s in Nairobi County.

5.5 Recommendations

There is need to provide a conducive environment for SME\'s to grow and thrive, therefore there is a need to develop strategies to enhance access to credit by SME\'s. It is important for the government to set up policies that will ease access to credit to SME\'s. This policies should be in harmony with both the owners of SME\'s and financial institutions in order to prevent putting hindrances to potential and credit worthy customers who seek to expand or start up a business. This will create a window for growth and development of the economy as a result of more job opportunities and increased flow of money circulation in the economy.

Financial institutions should ensure that they sensitize the owners of SMEs on best financial management practices. This will help the owners of SME\'s to account for loans borrowed. Lending institutions should also advise borrowers on how to appraise
their projects for viability to ensure that they make wise decisions when investing in projects.

5.5.1 Policy Recommendations

The study recommends the central bank should set policies and procedures to prevent barriers that inhibit potential owners and managers of SMEs from accessing credit facilities. This will enable will create a conducive environment for SMEs to growth and expand. It will also open up opportunities for jobs and this will enhance economic growth.

Financial institutions should also provide financial advisory services to individual proprietors when advancing credit to them; lower lending rates while improving service delivery and train people on risk management and financial management. The Government should also regulate financial institutions to ensure that the owners and managers of SMEs get access to information in order to make the right investment decisions.

The government should formulate policies that ensure commercial banks and other financial institutions provide adequate information on the requirements and procedures for applying for a loan. This will enhance efficiency and effectiveness of financial institutions since the borrowers are aware of what is expected. This will enable the owners of SMEs to easily access credit since they are informed of what is expected. The government should try hard to meet the credit needs of the SMEs in the country for a speedy economic growth through creating an enabling environment for financial institutions to thrive.
5.5.2 Suggestions for Further Study

This study focused on SMEs in Nairobi County and therefore the findings of this study cannot be generalized to SMEs outside Nairobi County. The study recommends that further research could be conducted on SMEs countrywide to investigate on the effects of access to credit on financial growth of SMEs to find out whether there are commonalities or unique factors.

Future researchers can also conduct a study in relation to access to credit and financial growth on SMEs in the East Africa region then findings and conclusions based on facts can then be reached and conclusions drawn. This will provide more insight on the significance of increasing access to credit to SMEs.

Future researchers can conduct a study on the effect of access to credit by commercial banks from other banks on growth of assets. This study will be beneficial since it will provide concrete evidence on the results of this study. Hence, conclusion based on facts can be made.

The study recommends that future research should lay more focus on SMEs in the rural setting in order to find out whether similar relationship exists between access to credit and financial growth in SMEs. This will provide more evidence on the level of access to credit for SMEs in the rural setting and in urban areas then the causes and effects can be documented.

In conclusion, this study adds to the bank of knowledge on the importance of access to credit to SMEs especially on its impact on financial growth of SMEs. It is evident that SMEs are a source of employment and highly contribute to growth of the
economy and therefore access to credit by SMEs is critical in facilitating their growth and development.
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APPENDICES

APPENDIX 1: LETTER OF INTRODUCTION

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
TO ALL RESPONDENTS,

Dear Sir/Madam,

RE: THE RELATIONSHIP BETWEEN ACCESS TO CREDIT AND FINANCIAL GROWTH OF SMALL AND MEDIUM ENTERPRISES IN NAIROBI COUNTY

I am a post graduate student at the University of Nairobi pursuing Master of business Administration degree in Finance. I am carrying out a research for a study as referenced above, among the Small and Medium Enterprises (SMEs) in Nairobi’s Central Business District in partial fulfillment of the requirements for the award of the degree.

I kindly request you to provide the five years (from 2009-2013) financial statements for your company /firm to enable me to gather the required information. My supervisor and I assure you that this information will be used purely for academic purposes and your name will not be mentioned in the report. A copy of final project shall be availed to you upon request. Your cooperation will be highly appreciated and thanking you in advance.

Yours faithfully,

Nathan Mwangi,
MBA Student,
University Of Nairobi.
### Appendix II: Net Assets and Borrowing Values

<table>
<thead>
<tr>
<th>YEAR</th>
<th>2009 KES '000'</th>
<th>2010 KES '000'</th>
<th>2011 KES '000'</th>
<th>2012 KES '000'</th>
<th>2013 KES '000'</th>
</tr>
</thead>
<tbody>
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<td><strong>Tom Mboya</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Assets</td>
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<td>9,642.50</td>
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<td>13,120.33</td>
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<tr>
<td>Net Assets</td>
<td>162,857.48</td>
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<td>205,486.03</td>
<td>240,770.33</td>
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<td>Borrowings</td>
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<td>11,455.00</td>
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<tr>
<td><strong>Moi Avenue</strong></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Assets</td>
<td>191,773.38</td>
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<td>Borrowings</td>
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<td>13,267.50</td>
<td>10,688.68</td>
<td>17,610.98</td>
</tr>
<tr>
<td><strong>River Road</strong></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Net Assets</td>
<td>128,523.65</td>
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<td>158,826.48</td>
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<td>Borrowings</td>
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<td>8,797.15</td>
<td>13,992.50</td>
<td>12,829.60</td>
<td>19,188.58</td>
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<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Assets</td>
<td>599,029.08</td>
<td>663,230.00</td>
<td>735,884.43</td>
<td>847,516.30</td>
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<td>Borrowings</td>
<td>22,525.75</td>
<td>30,022.25</td>
<td>48,357.50</td>
<td>39,946.78</td>
<td>65,648.03</td>
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</tbody>
</table>

### Average

| | 2009 | 2010 | 2011 | 2012 | 2013 |
| | KES '000' | KES '000' | KES '000' | KES '000' | KES '000' |
| **Net Assets** | | | | | |
| Average Turnover (Values) | 20,656.18 | 22,870.00 | 25,375.33 | 29,224.70 | 32,866.98 |
| **Borrowings** | | | | | |
| Average Turnover (Values) | 776.75 | 1,035.25 | 1,667.50 | 1,377.48 | 2,263.73 |

### Appendix III: Sales Values

<table>
<thead>
<tr>
<th>YEAR</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>KES '000'</td>
<td>KES '000'</td>
<td>KES '000'</td>
<td>KES '000'</td>
<td>KES '000'</td>
</tr>
<tr>
<td>Average Turnover (Values)</td>
<td>65,676.56</td>
<td>63,698.83</td>
<td>55,289.29</td>
<td>74,876.63</td>
<td>84,779.43</td>
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### Appendix IV: Sample List

<table>
<thead>
<tr>
<th></th>
<th>Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Arsman Consultants</td>
</tr>
<tr>
<td>2</td>
<td>Carole Investment</td>
</tr>
<tr>
<td>3</td>
<td>Digital Tablet Enterprises</td>
</tr>
<tr>
<td>4</td>
<td>Ebrahim Ltd</td>
</tr>
<tr>
<td>5</td>
<td>Elevetus Technologies</td>
</tr>
<tr>
<td>6</td>
<td>Feli Investment</td>
</tr>
<tr>
<td>7</td>
<td>Galitos</td>
</tr>
<tr>
<td>8</td>
<td>Global Computer solutions</td>
</tr>
<tr>
<td>9</td>
<td>Guelph Agrovet</td>
</tr>
<tr>
<td>10</td>
<td>Highlands Hotel</td>
</tr>
<tr>
<td>11</td>
<td>Idris Enterprise Ltd</td>
</tr>
<tr>
<td>12</td>
<td>Jade Collections</td>
</tr>
<tr>
<td>13</td>
<td>Kamwara shopping Center</td>
</tr>
<tr>
<td>14</td>
<td>Krumble Restaurant</td>
</tr>
<tr>
<td>15</td>
<td>LifeBridge Clinic</td>
</tr>
<tr>
<td>16</td>
<td>Mariposa hotel</td>
</tr>
<tr>
<td>17</td>
<td>Marshal Entertainment</td>
</tr>
<tr>
<td>18</td>
<td>Mr Price</td>
</tr>
<tr>
<td>19</td>
<td>Nairobi Sports</td>
</tr>
<tr>
<td>20</td>
<td>Office Mart Ltd</td>
</tr>
<tr>
<td>21</td>
<td>Optica Ltd</td>
</tr>
<tr>
<td>22</td>
<td>Penton solutions</td>
</tr>
<tr>
<td>23</td>
<td>Seal Honey Ltd</td>
</tr>
<tr>
<td>24</td>
<td>Sharama Movers and Shakers</td>
</tr>
<tr>
<td>25</td>
<td>Stralet Motors</td>
</tr>
<tr>
<td>26</td>
<td>Tekko Tours and Limited</td>
</tr>
<tr>
<td>27</td>
<td>Terry Russel Properties</td>
</tr>
<tr>
<td>28</td>
<td>Thorn Café Ltd</td>
</tr>
<tr>
<td>29</td>
<td>Transchem</td>
</tr>
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</table>
Appendix V: Geographical Appendices

Geographical Map I
Geographical Map II
Geographical Map III