THE EFFECT OF BANK CREDIT ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN DAGORETI NORTH CONSTITUENCY

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DECLARATION

This Project is my own original work and has never been presented for a certificate award in any other college.

Signed………………… Date……………………………

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This Project has been submitted for examination with my approval as the candidate supervisor.

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DEDICATION

I dedicate this work to my family members for their tremendous support during my research work. Special thanks to my parents for their great inspiration.

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LIST OF ABBREVIATIONS

DNC	-	Dagoreti North Constituency
GDP	-	Gross Domestic Product
K-REP	-	Kenya Rural Enterprise Program
MENA	-	Middle East and North Africa
SMEs	-	Small and Medium Enterprises
SPSS	-	Statistical Package for Social Sciences
UNDP	-	United Nations Development Program
UWFT	-	Uganda Women Finance Trust

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ABSTRACT

The Small and Medium size enterprises present the most dynamic economic foundation for growth, income and employment creation. However, this vital sector has been greatly affected by lack of credit by financial institutions in Kenya. The main objective of the study is to assess the impact of bank credit on the financial performance of Small and Medium Enterprises. The researcher employed descriptive research design. Data was collected based on the objectives and questionnaires were distributed to 40 respondents. Descriptive statistics such as frequency distribution, Percentages, variations and measures of central tendency were used to summarize basic features of the data in the study. Inferential statistics were used to infer the sample results to the population. The study established that availability of capital resources greatly affects the financial performance as well as investment levels among SMEs forcing investors and potential investors to depend on own savings and funds from friends and relatives. Also it is well established that the size of the firm influence its ability to access credit from financiers. The ability of small and medium enterprises to access credit was found to be a significant ingredient towards SMEs growth. This could be out of the fact that unlike established companies, most SMEs do not have goodwill with banks and therefore, their access to financing is limited due to lack of collateral and previous history. The study recommends for establishment of policies to enable SMEs access financing without any hindrance. This will deal with the key issues hindering SMEs access to credit, namely; high cost of finance and availability of required collateral. The study recommends for the establishment of a fund that would be advancing subsidized credit to SMEs this will deal with the issues hindering SMEs access to credit for SMEs. Further proper legal framework should be put in place in order to help small and medium enterprises raise more capital for growth.

CHAPTER ONE: INTRODUCTION

1.1 Back ground to the Study

Business financing is a very important factor in growth and financial performance of businesses. One of the most difficult problems in the new ventures and especially the small scale businesses is obtaining financing, especially bank credit. For the entrepreneur, available financing needs to be considered from the perspective of debts versus equity and using internal versus external funds. Butterfields (2008) noted that the external finances or credit facilities are the types of finance that is obtained from persons other than the actual owners of the company that is creditors to the company. The external finance or credit facilities can be in any of the following forms; loans, debentures, overdrafts, lease finance and trade creditors (Manasseh, 2004).

Finance has been viewed as a critical element for the development of small and medium scale enterprises. Previous studies have decried the limited access to financial resources available to small and medium enterprises compared to large organizations and the consequences for their growth and development (Berger and Udell, 2004). Typically small and medium scale enterprises face higher transactional costs than larger enterprises in obtaining bank credit (Lee, 2004).

Small and medium scale enterprises often operate at such a low scale that is unattractive to banks (Ugoani and Dike 2013).Many of them are unincorporated and banks are not forthcoming in investing in a multiplicity of small ventures that are scattered all over the country. Besides, small and medium scale enterprises are mostly family businesses and they are therefore reluctant to open their business up, especially to banks that they regard as intruders. The concomitant effect is that less financial credit facilities are made available to small and medium scale enterprises by financial institution such as banks.

1.1.1 Bank Credit

Bank credit is the borrowing capacity provided to an individual by the banking system, in the form of credit or loan. The total bank credit the individual has is the sum of the borrowing capacity each lender bank provides to the individual. Bank credit has to do with the amount of funds that an individual or a business may be able to borrow from one or more lending institutions. In effect bank credit is a measure of how much in the way of cash loans may be issued, based on the credit history and assets of the company or person. Because bank credit focuses on the borrowing capacity of the individual or business entity, the premise is a little different than the extension of a line of credit. First, a bank credit has to do with loans that are taken out of specific purpose, rather than general purposes. Secondly, they often involve some sort of collateral that helps to ensure the repayment of the loan in the event of default (Jonathan and Stephen, 2007).

Bank credit can be measured by parameters such as loan size, loan period, interest rate and processing period among others. The effects of bank credit on the financial performance may include, increased stock, increased customer base, increased assets; improved technology, increased revenues and profits. In order to offer bank credit, banks accept deposits from the public against which they provide loans and other form of advances. Since they bear a cost for carrying these deposits, banks undertake lending activities in order to generate revenue. The major sources of revenue comprises of margins, interests, fees and commissions. These are therefore costs to the small and medium enterprises (Odongo, 2004).

Financial institutions such as banks offer finances to businesses which are mostly short term in nature. This is because the deposits made with them are demand deposits, which cannot be lent on long term basis. Due to this fact the financing role of commercial banks is limited to short term loans exceeding four years. Short term loans range from three months to a maximum of four years and are given to established customers of the banks who have the necessary security. These are expensive as the customers will have to only pay interest on them, but also the insurance of the security (Manasseh, 2004).

1.1.2 Financial Performance

Financial performance is the positive generation of income in monetary terms by the business. It is an increase in revenue generation in the business. Financial performance can be measured by increase in income, revenues, sales and profits. Blair put forward five major areas in which financial performance can be measured, these include, liquidity, solvency, profitability, financial efficiency and repayment capacity (Borrus, 2002).

The measure of financial performance of SMEs are performance indicators which are commonly used to help an organization define and evaluate how successfully it is, typically in terms of making progress towards its long term organizational objectives (Gibbson 1990). They are therefore quantifiable measurements agreed to beforehand, that reflect the critical success factors of an organization. Measurement of actual financial performance must be done in the same terms in which standards have been laid down so that comparisons are easier and meaningful. SMEs financial Performance can be measured in monetary terms like profits, costs, expenses, incomes or revenue, savings and value of assets held.

It can also be measured quantitatively like units of production, units of sales / percentage of market share and quantity of stock held. In terms of time measurement, it includes man- hours or machine - hours. Financial Performance of SMEs can also be measured in terms of capital employed typically expressed in financial terms as rate of return on investment or in terms of current ratio arrived by dividing current assets to current liabilities (Ivancevich, 1980). It is important to note that the key performance indicators will differ depending on the organization but whatever measurements are selected they must reflect the organizational objectives, they must be key to its success and they must be quantifiable (measurable).

1.1.3 Bank Credit and Financial Performance

Theoretically, all other factors held constant, it is expected that the bank credit (loans, debentures, overdrafts, lease finance and trade creditors) should lead to improved financial performance (increased profits, reduced costs, reduced expenses, increased incomes or revenue, savings and value of assets) of the small and medium enterprises. In general the growth and financial performance of business may be affected by its capital base which is equity and debt. The capital depends on its balance between own sources and borrowed sources of capital, or the amount attributable to credit. There may be many reasons available for this situation, the study concentrated on how the following factors affect the financial performance of small and medium scale trader`s due to the accessibility of credit facilities. They include; principal bank credit, interest rate, literacy levels, the number of lending institutions, and the security for the loans.

Small businesses are often thought to be an important source of employment, innovation and economic growth. In many developing countries, small and medium enterprises (SMEs) make up a large share of registered businesses, but a much smaller share of GDP. Data from several countries suggest that few SMEs grow to become larger businesses. One reason could be that unlike larger businesses, SMEs have limited access to bank credit, preventing them from making larger investments to improve their operations, upgrade to new technologies, or expand (Bryan, 2013).

Most SMEs' credit financing needs exceed the small loans that microfinance institutions provide. Yet larger commercial banks often find it too expensive to lend to SMEs because the cost of assessing whether an SME is creditworthy is high relative to the return banks could earn by lending to them. Many banks also perceive SMEs as being too risky and more likely to default on loans. Credit scoring has been used extensively in developed countries to reduce the cost and time required to process loan applications and to assess the riskiness of loan applicants in order to make small business and consumer lending profitable for banks. Can a credit-scoring system increase lending to SMEs in emerging markets, and does access to credit improve these businesses' profitability? How does increased access to credit affect other businesses in the same market, namely the competitors, suppliers, and customers of businesses receiving loans? (Bryan, 2013).

The numbers of small scale traders are many, while the financial institutions with the services tailored to them are few. The credit requirements of the SME'S traders are different from those of the large businesses. This is due to fragile nature of the business among other considerations, such as size, management structure, the capital base etc. Therefore there is need to have many lending institutions whose lending policies are established with such factors in considerations. The few institutions with such considerations are faced by the many small scale traders whose financial demands they may not cater for. This means that there is a positive correlation between bank credit and the financial performance of small scale enterprises (Ataya, 2009).

1.1.4 Small and Medium Enterprises in Dagoreti North Constituency

The study was conducted in Dagoreti North Constituency. The Constituency has variety of small and medium businesses which includes; agro business shops, chemists, general shops, butcheries, supermarkets, cyber cafés, among others (Kenya economic survey, 2009). There are several branches of banks in the constituency and many more are expected to open more branches in the constituency given the high concentration and competitions of small scale business in the area. Small and micro enterprises are the life blood of the economy in Dagoreti North Constituency. They are at the fore front of the government effort to promote enterprise, create employment among youth and women, innovation and increased productivity. Small and micro enterprises will continue to be the main providers of new jobs and revenue to banking institutions (Hewitt, 2000).

The roles and importance of bank credit, small and medium businesses to the economies of both the developed and the developing nations has been the subject of increased studies and scrutiny particularly in Kenya for the last decade. This is due to belief that a prosperous and a dynamic Small and Medium Enterprise sector is crucial to financial performance of a dynamic economy (Beaver, 2002). However for this sector to continue growing unabated there is need for flow of bank credit financing, which is currently being evidenced by presence of banks in Dagoreti North Constituency. The study seeks to find out the effect of bank credit on the financial performance of small and medium enterprises in Dagoreti North Constituency.

1.2 Research Problem

Small and medium enterprises are the major agents of economic growth and employment in Kenya, over sixty percent of small businesses are estimated to financially underperform hence fail each year (Kenya national bureau of statistics,2007).Despite the efforts of banking institutions such as k-rep, family finance, Kenya women finance trust, equity bank among others to take credit facilities within the reach of poor people and SMEs, who have still not benefited from the conventional formal financial system, the (SMEs) sector had not shown any sign of growth and expansion (Kenya economic survey, 2009).

It is rear to find businesses which have performed financially well without securing credit facility from financial institutions such as banks. Bank credit has been a source of growth and stability in the financial performance of small and micro enterprises. The availability of finances to small and micro enterprises, all other factors held constant, will result to an increased financial performance of the business. An appropriate banking environment is considered a key pillar as well as an enabler of economic growth (Koivu, 2002).

Aczel (2000) conducted a study in Thailand on the role of bank credit in supporting small and medium entrepreneurial endeavor. The findings of the study indicated that the involvement of banking institutions in promotion of small and medium enterprise and processing industry plays a key role in economies of developed countries as a source of goods and services, income, savings and employment. Furthermore, the industry provides information, knowledge, and skills and often links entrepreneurs to information service providers.

Wanjohi and Mugure (2008) in acknowledging that bank credit sources remain a major challenge yet very critical in the financial performance among the SME's in Kenya, found out that, in the climaxing of the year 2008, money lenders in the name of 'pyramid schemes' came up promising better financial growth among the small investors and that they can make it to financial freedom through soft borrowing. The rationale behind turning to these schemes among a good number of entrepreneurs is to seek cheap source of credit which is not available among the formal financial institutions such as banks.

Many studies have been done on the effects of the bank credits on the small and medium scale traders in Kenya, but none has been done specifically for the DNC. Therefore, the researcher undertakes the study with an objective of investigating the effects of bank credit on financial performance of small and medium enterprises in Dagoreti North Constituency. To achieve the above objective, the study will be guided by the research question; what is the contribution of the bank credit to financial performance of small and medium scale enterprises in Dagoreti North Constituency?.

1.3 Research Objective

The objective of the study was to find out the effects of bank credit on financial performance of small and medium enterprises in Dagoreti North Constituency.

1.4 Value of the Study

The study contributes to the body of knowledge available in the area of bank credits to small and micro enterprises. There has been increased activity from financial institutions on loan facilities targeted at small and medium traders. Many banks for instance have started projects and put a lot of resources, their aim being to increase revenue by attracting more of these traders. The result of the survey would therefore be of so much significance to these financial institutions especially banks since they would know from the results of the study the effects of bank credit to the financial performance of the small and medium enterprises and be able to assist these entrepreneurs to attain this goal and at the same time increase their lending capacity.

It is of value to the students of finance because, it forms basis for further research in this area. Knowledge is cumulative, important information can be acquired about a research topic from similar work done, on the same area of research by future financial researchers. Therefore, the study is of much significance to the research institutions, finance students and other researchers who would get the findings useful in their investigation in this area of study.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter sought to review the various issues which in one way or another may help the researcher, to address the effects of bank credit on the financial performance among the Small and Medium Enterprises within the Dagoreti North Constituency. This chapter outlines, Theoretical Review, Determinants of Financial Performance of SME`s, Empirical Review and Summary of the Literature Review. It also reviewed the key factors which affect the financial performance. These includes, the literacy levels, financial resources, the interest rates charged, Information accessibility, Technology, Government support and the demand for collateral from traders by financial institutions.

2.2 Theoretical Review

Before diving into the determinants of financial performance, empirical review and analytical discussions about the effect of bank credit on the financial performance of small and medium enterprises, it is important to situate the argument within a theoretical context. This includes theories that deal with the entrepreneur in theories of the Firm, theories of entrepreneurial choice, and theories of stage of development.

2.2.1 The Entrepreneur in Theories of the Firm

In static theories of competitive equilibrium, the size of the firm is determined by the efficient allocation of given resources, including entrepreneurial resources, under given technologies. Accordingly, the observed firm size is the efficient size, in the sense that long run costs are minimized at that point. Growth follows from the assumption of profit-maximizing behaviour and from the shape of the cost functions. A firm will grow until it has reached the size where long run marginal costs equal price, which is assessed as the "optimum" size of the firm.

Thus, Lucas (1978) equates the firm with the entrepreneur or manager and he assumes that a firm's output is a function of managerial ability as well as capital and labour. Lucas postulates therefore one production technology subject to constant returns to scale, and a separate managerial technology with diminishing returns to scale or "span of control." Managers with higher abilities (i.e., higher efficiency levels) will have lower marginal costs and therefore will produce larger outputs. However, firm expansion will be limited due to decreasing effectiveness of the manager as the scale of the firm increases. An implication of the Lucas model is that, for a small business to grow, the small business owner must be willing and able to relinquish many day-to-day control functions and delegate those tasks to an enlarged, specialized management team.

According to Lucas' theory, the variation in levels of business acumen is the major determinant of business growth (as well as of business formation and dissolution). Alternatively, as proposed by Kihlstrom and Laffont (1979), the major determinant of business growth is the differing taste for risk among individuals. Thus, Kihlstrom and Laffont assume that production technology is risky, and that entrepreneurs who have the ability or propensity to take risks in the face of uncertainty will produce more output. Firm size is therefore limited by the entrepreneur's willingness to take risks. The theories discussed above are static. They say little about how an industry and the firms within it evolve over time and they ignore the fact that individuals can learn their business acumen by operating businesses over time.

2.2.2 Theories of Entrepreneurial Choice

Theories of small business growth have extended analysis of the decision to start a business to that of the decision to grow the business. According to Davidsson (1991) firm financial performance and growth is an indication of continued entrepreneurship. Davidsson notes that economic theories take the willingness to grow a business for granted, by assuming profit maximization. However, empirical evidence suggests that small business owners are reluctant to grow even if there is room for profitable expansion and that profitable firms of different sizes co-exist within industries. Thus, Davidsson argues that growth is a choice of the owner-manager and that profit maximization is only one of the possible motives for business growth.

Davidsson draws from psychological theories of motivation, which recognize that individuals differ in their motivational make-up. According to the "Need for Achievement" motivation theory, individuals differ in the degree they strive for achievement satisfaction. If profit is used as a measure of success, then the striving for achievement coincides with the behavior predicted by profit maximization, but he stresses that the latter is neither the sole nor the dominant motive for growth. Indeed, in empirical models of small firm growth, the characteristics of founders of businesses were linked to their growth aspirations (Davidsson 1989, Kolvereid, 1990, Gundry and Welsch, 1997), and the growth performance of their ventures (Kimberly 1979, Cooper *et al*., 1994).

2.2.3 Theories of Stage of Development

Business development and growth is a core topic in entrepreneurship and organization theory Indeed, commitment to business growth is seen by at least one influential entrepreneurship school of thought as a basic distinguishing feature of entrepreneurial firms and virtually all economic models of business creation follow firm birth with firm growth. It is generally recognized that new businesses that do grow contribute significantly to the financial and economic development of regions and nations (Autio, 2007).

According to the influential theory of Churchill and Lewis (1983) growth is part of the natural evolution of a firm. The author identifies five stages of growth: existence, survival, success, and takeoff and resource maturity. In each stage of development a different set of factors is critical to the firm’s survival and success. Growth thresholds may exist as obstacles to the transition from one stage to another. Accordingly, in the take-off stage most relevant in a study of rapid growth there are two major concerns or obstacles to firm growth: the ability of the owner to hire new people and delegate responsibility. The business will also need enough cash to satisfy the greater demand for financial resources brought about by growth.

2.3 Determinants of Financial Performance of SME`s

Apart from the bank credit there are other factors that influence the financial performance of the small and medium enterprises. Financial performance of any business is as a result of many other underlying factors and these includes, Financial Resources, Interest Rate of Credit, Information Accessibility, Technology, Government Support, marketing strategies, entrepreneurs time, Education Level and Management Skills among other factors.

2.3.1 Capital Resources

Capital resource is a productive asset such as equipment, inventory, and plant that (unlike a natural resource) is man-made and employed in generation of income. Financial resources are of vital importance for a business to run operations profitably. SMEs have comparatively limited resources and greater difficulty in accessing the funding sources, are more dependent on a single product, have less adequate budget control system, lack economies of scale (Thurik,2007). In a recent research study on SME's in Indonesia founded that SMEs operate on traditional lines in marketing. Strict reaction on account of competition should be responded proactively by SMEs by doing business development and research (Robert, 2007).

2.3.2 Firm Size

Firm size is one of the most important variables in literature related to access to bank credit and financial performance. Numerous studies have discussed that small and medium enterprises are financially more constrained than large firms. For example, Calomiris & Hubbard (1990) noted that when the company is smaller, the restriction on credit is greater. Previous studies have mentioned several reasons for Small firms to have less access to bank credit which affects the financial performance of the businesses. Firstly, the small firms face with information opacity such as unable to provide financial information (Binks & Ennew, 1996). When the firm is small, most of the time it is owned and operated by the entrepreneur and there is no such legal requirement to regularly report financial information and many firms do not maintain audited financial accounts.

In addition, smaller firms have lesser assets to offer as collateral. In order to reduce the anticipated risk and moral hazard associated with lending, the banks use collateral as one of the instruments. The collateral is an assurance to the bank in case of default and it also ensures the borrowers commitment to the loan repayments. Berger and Udell (1995) found smaller and younger firms are more likely to face higher cost of financing and they are required to offer collateral

2.3.3 Age of the Firm

According to Pandula (2001), a number of studies have found that there is a correlation between firm age and financial performance of small and medium enterprises. Being in the business for many years suggests that the firms are at least competitive on average. It can be argued that being an older firm means there is lower informational opacity and more experience in business activities hence this has effect on the financial performance of small and medium enterprises. The reason is information required by the lenders to evaluate and process applications is readily available because these businesses have an established reputation or track record, and the credit obtained can be used to raise the financial performance of the firm.

On the other hand, the new firms are not likely to meet the collateral requirements of the banks since they have not accumulated sufficient assets. Combined with the absence of Information on their financial records, this makes difficult to lenders to assess lending proposals submitted by new firms. The studies conducted in the past have found that the financing constraints are particularly severe in startup enterprises and relatively young firms (three years old or less).

2.3.4 Technology

Technology also plays an important role in the financial performance of small and medium enterprises. Technology has a close relationship with improvement of production process hence the improved financial performance of the business. Different studies have also revealed the similar results that lack of new technology and equipment are hindrances of SME`s development (Swierczek & Ha 2007). Firm that uses the latest technology tends to capture its customers more than its competitors. Although technology has its cost but in the end business usually recovers this cost as they operate. Still they are able to get an edge over its competitors by application of new technology.

In the third world countries most of the SME's are not able to install new technology due to its higher cost. But from previous researches it is founded that technology has its deep roots in the business success of the SMEs and positively correlated with the business success of an SME founded by (Cartsson, 2008). In the most recent study on the SME's it was found that financial flexibility was significantly correlated to business success and financial performance. SME's that took the advantage of gaining the capital from a third party such as banks and other financial institutions usually enjoy the better chances for its financial performance and success (Pitman, 2008).

2.3.5 Productivity

Although it is difficult to construct the measures for firm performance in the SME sector, many studies have attempted to do this and found that greater sales and profits are associated with greater financial performance (Topalova, 2004). In addition, firms with increasing sales and increasing sales turnover ratios would be expected to have improved financial performance (Pandula, 2011). Most of the governments in the world are focusing on their support programs for the SME sector productivity and development, in order to sustain a stable and productive national economy (Butler, 2008).

One of the significant characteristics of a flourishing and growing economy is a booming and productive small and medium enterprises (SMEs) sector. Small and medium enterprises play an important role in the development and production of a country economy (Curran, 2007). SMEs contribute to economic development in various ways: by creating employment for rural and urban growing labor force, providing desirable sustainability and innovation in the economy as a whole. In addition to that, large number of people relies on the small and medium enterprises directly or indirectly (Curran, 2007).

2.3.6 Education Level and Management Skills

It is believed that well-planned business activities as manifested in a business plan will yield a better business financial performance. In Indonesian study, it was revealed that entrepreneur literacy level, planning, organizing and directing has positive relationship with the success and financial performance of an SME (Huggins, 2007). All the above mentioned variables have vital importance in the business success of SMEs as many previous researches have supported these variables and found a deep connection between these variables and business success of an SME.

According to King and McGrath (2002) those with more education and training are more likely to be successful in the small and medium enterprises sector. The literacy level was reflected in their ability to carry out managerial routines. The routine includes making decisions on financial investment and management. This affects the decision on the external funding such as bank credit and hence the financial performance of his enterprise. Due to low literacy levels most SME traders are unable to differentiate the loan products offered by the financial institutions. Since most of these services are offered in banking jargons, most traders are discouraged from applying for the loans. Further inadequacy in financial management skills and strategic planning put the SME's in a disadvantaged position in competing with a large firms which are run by well educated professional managers hence reduction the level of the financial performance of the small and micro enterprises.

2.4 Empirical Review

Aczel (2000) conducted a study in Thailand on the role of bank credit in supporting micro entrepreneurial endeavor. The findings of the study indicated that the involvement of banking institutions in promotion of micro enterprise and processing industry plays a key role in economies of developed countries as a source of goods and services, income, savings and employment. Furthermore, the industry provides information, knowledge, and skills and often links entrepreneurs to information service providers.

Matovu (2006) researched on bank credit and poverty alleviation in Uganda. His objective of study was to examine the impact of bank loans on rural women in Kayunga-Central Uganda. According to research findings, majority of women clients of Uganda Women Finance Trust had registered increased incomes from their microenterprises. From these incomes they were able to solve some problems of poverty like isolation, physical weaknesses and could afford a good diet. They were also able to send their children to school and to pay for their health which is critical for their continued wellbeing and as a consequence break the poverty trap. The findings also reported that clients increased incomes enabled them to save and to buy property.

Rahmat and Maulana (2006) researched on the impact of bank financing to Micro and Small Enterprise's Performance in Indonesia. Results of the study indicated that bank financing has positive impact on improvement of SME's financial performance indicated by sales. Doubling the amount of loan was found to have a negative impact on the financial performance indicated by income and savings. To address this negative impact, the recommendation was that it is very important to allocate the loan to the productive activities, such as investment, in a way that improves the business opportunity.

Mochona (2006) studied the impact of bank financing in Addis Ababa-Ethiopia. He assessed the impact of bank financing on women micro enterprises that were clients of Gasha finance Institution. The research findings indicated that only a few of the women clients of the Gasha finance Institution reported increased incomes from their micro enterprise activities. It was also noted that majority of the respondents expressed dissatisfaction with the loan processing procedure and time taken to secure the loan. Most clients faced major risks in running their businesses and therefore dropped out of the bank financing program as they were pushed into indebtedness and could not repay the loans. The study recommended giving individual loans instead of group loans and that extending the loans beyond the maximum loan size ceiling of 2000 Birr to match varying borrowing powers of clients may meet credit and business needs of diversified clients.

Makokha (2006) revealed that inadequacy of capital hindered the expansion of small and medium enterprises in Kenya. The study further found that larger loans enabled SMEs to graduate to medium enterprises by improving their financial performance. This study also indicated that those SMEs that received large loans frequently had larger labour force than those SMEs that received smaller loans. Appropriate loan sizes for clients matching their needs, realistic interest rates, savings as a prerequisite, regular, short and immediate repayment periods and achieving scale can contribute to the sustainability and improved financial performance of small and medium enterprises in Kenya.

K'Aol (2008) in his research paper on the role of bank financing in fostering women entrepreneurship in Kenya assessed the impact of bank finance funding on women entrepreneurship in Kenya. The population consisted of women entrepreneurs who had benefited from four major Kenya Rural Enterprise Program (K-REP) bank finance schemes within Nairobi and Nyeri. The findings revealed that most of the respondents in this study reported that their business had expanded and their house hold income had increased significantly as a result of having taken bank loans from K-REP. The most significant impact evident among the women entrepreneurs involved in farming activities was that the number cattle they owned had doubled after taking the loan.

Ojo (2009) in his research on the role of bank financing in entrepreneurship development found out that there was a significant difference in the number of entrepreneurs who used banking Institutions and those who do not. Bank financing is sustainable to the development of entrepreneurship activities in Nigeria and that bank financing has affected entrepreneurship in the country positively. He concluded that financial institutions have a positive relationship with the Nigerian economy represented by expanded GDP. Although the interest rate is not significantly influential, financial institutions and their activities go a long way in the determination of the pattern and level of economic activities and development in the Nigerian economy.

Habibulla (2011) in is studies found that bank loans increased the income of MSEs operators and poor people in Bangladesh and Zimbabwe respectively. Is studies focused on business financial performance in terms of increased sales, acquisition of asset and technology while household studies focused on increased income from firms as profit or wages and salaries to establish a link between the availability of bank credit and overall well being of the poor. Thus, both research and practice have seen an increasing concern about the banking Institutions' lending and MSEs financial performance.

Rocha (2011) investigated the status of bank financing to SMEs in the Middle East and North Africa (MENA) based on a survey of 139 banks in 16 countries. The authors found that in spite of a positive perception of the attractiveness of the segment, the SME sector in the region remains largely underserved and that all banks in the sample are interested in serving the SME segment. To do so, almost all have separate organizational units and offer a wide range of products, applying different transactional technologies such as credit scoring or risk-rating systems which indicated that most of the SMEs in the region had performed poorly financially despite bank loans. Direct government interventions through public banks, credit guarantee schemes and other forms of subsidized financing play a major role in SME lending, partly compensating for the low level of private sector involvement, which in turn reflects the MENA's weak financial infrastructure. The authors conclude that the conventional wisdom according to which large banks are not attracted by SMEs and that this business is dominated by small banks and based on relationship lending does not hold in practice and it leads to poor financial performance.

2.5 Summary of the Literature Review

Empirical evidence emerging from various studies above indicates that bank credit may or may not lead to improved financial performance therefore the studies are not conclusive. Studies such as Rocha (2011) above, about whether the bank credit on SMEs improves financial performance, has so far yielded mixed results that are inconclusive especially for developing countries like Kenya. In spite of this emphasis, previous studies did not provide sufficient justification for the link between bank credit and SMEs financial performance and whether the bank credit has any effect on the financial performance of SMEs in the developing countries like Kenya and in particular Dagoreti North Constituency.

So far no study has been carried out in Dagoreti North Constituency on the effect of bank credit on the financial performance of the SMEs in the area. As a matter of fact, the question of whether bank credit improves or worsens SMEs performance in Kenya is stills worthy of further research such as the one being undertaken in this study. In addition, the effect of bank credit on the SMEs financial performance has not received adequate attention in Dagoreti North Constituency. This means there is a major gap in the relevant knowledge on developing countries including Kenya, which has to be covered by this research in Dagoreti North Constituency.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter focused on the research processes and methods that were used in obtaining data for the research. The research design was made up of the sampling and sampling techniques. This chapter also discussed data collection tools and procedures as well as the analysis of the information collected and the various forms that the data collected was presented.

3.2 Research Design

This study applied descriptive design where quantitative data was collected using instruments such as questionnaire. Descriptive research seeks to identify characteristics of users of a given product therefore the questionnaire was designed to elicit information from the target population (all micro businesses in Dagoreti North Constituency) as to the effects of bank credit on the performance of their small and medium businesses. The use of this design was necessary because descriptive research encompasses the collection of a wide range of social indicators and economic information such as household expenditure patterns, time use, and statistics on changes in business size and the like. Structured questionnaire containing both open and close ended questions was used to obtain information from the respondents.

3.3 Population

The target population in this study was all the entrepreneurs in Dagoreti North Constituency, who run SME's and have taken bank credit. For the purpose of this study an SME was described as any business with an annual turnover of under Kshs 5 million. The researcher was unable to obtain the exact number of SME traders in Dagoreti North Constituency, since there is no existing database, as most of them are neither registered nor licensed. However the local authorities indicate that there are 400 hundred registered SME's in the area of study (Kenya Economic Survey, 2009). Due to financial and time constraints the researcher will not collect data from every entrepreneur in the study.

3.4 Sampling Design and Technique

Sampling involves determining the participants in the study. It is however necessary because one cannot usually include everyone in a study. Consequently, you need to select a smaller group of participants from the larger population. In sampling there are two types' Probability and non-probability sampling. This study made use of probability sampling Method, specifically stratified sampling since the population was selected based on the five Administrative areas. Random sampling was used to ensure that each element in the population of study has an equal chance of being in the sample. A sample of units was selected from the population on which Generalization was made. Sampling has an advantage over complete enumeration especially in cost, time and accuracy of results.

The researcher prepared a list of bank credit beneficiaries from the five markets. These are the SMEs who have been receiving bank credit from different sources and keep records of their business performances to enable make comparisons of their performances before and after accessing credit. The researcher hired five research assistants to compile the list from each of the five strata, which are the administrative unit namely Gatina ward, Kilimani ward, Kileleshwa ward, Kawangware ward and Kabiro ward.

A sample of 40 MSEs was drawn proportionately from the strata. For homogeneous groups, 10% of the sample is considered as representative (Mugenda & Mugenda, 2004). Elements from each stratum were selected using random sampling technique to give each element an equal chance. Furthermore, based on past studies conducted on Performance of MSEs, (Kibas, 1995, Sebstad and Walsh, 1991) used between 15 and 20 SMEs in their studies while the current researcher's population is more by two times and therefore the sample size in this study was 10% of the population which totaled to 40 SMEs.

3.5 Data Collection

Structured questionnaire containing both open and closed ended questionnaires were used to obtain information from respondents. The first part of the questionnaire had the background information about respondents such as gender; age and educational background etc. Some of questions were very specific with a fixed range of answers. The structured questionnaire had multiple-choice questions in which the researcher provided a choice of answers and respondents were asked to select one or more of the alternatives and dichotomous questions that have only two response alternatives, yes or no.

3.6 Pilot Testing

According to Joppe, (2007) reliability the extent to which results are consistent over time and an accurate representation of the total population and if the results can be reproduced under a similar methodology while validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are.

3.6.1 Reliability

To establish validity, the research instrument was given to two experts experienced in strategic change implementation to evaluate the relevance of the four variables. The same was rated on the scale of 1 (very relevant) to 4 (not relevant). Validity was determined through application of content validity index. The content validity index was obtained by summing up the items rated 3 and 4 by the experts and dividing this sum by the total number of items in the questionnaire. Bryman (2012), suggest that where Cronbach's Alpha is used for reliability test, the rule of the thumb is that Cronbach's Values of the items included in the study should not be lower than 0.7. In order to increase the reliability of the questionnaire, this study applied Cronbach's Alpha for separate domains of the questionnaire. A content validity index of 0.616 to 0.84 was obtained. Oso and Onen (2009), stated that a validity coefficient of at least 0.70 is acceptable a valid research hence adoption of the research instrument was valid for this study.

3.6.2 Validity

According to Mugenda and Mugenda (2003), validity is the accuracy and meaningfulness of inferences, based on the research results. One of the main reasons for conducting the pilot study is to ascertain the validity of the questionnaire. Validity was used to determine whether the study measured what it intended to measure and to approximate the truthfulness of the results. The study applied both face and content validity to ascertain the validity of the questionnaires. Content validity draws an inference from test scores to a large domain of items similar to those on the test. Content validity is concerned with sample-population representativeness. Gillham (2008) stated that the knowledge and skills covered by the test items should be representative to the larger domain of knowledge and skills.

3.7 Data Analysis

The independent variable, Bank credit, is the amount of funds that a business may be able to borrow from one or more banking institutions and it was measured by parameters such as loan size, loan period and interest rate. The dependent variable, financial performance, is the positive generation of income in monetary terms by the business. It was measured by variables such as changes in level of assets, Stock, sales, profitability and number of employees. Financial performance was looked at in terms of financial strength of the enterprise. Stoner (1996) reveals that profitability has been the most widely used measure of financial performance. Profitability is the excess of income and expenditure which can be expressed by ratios of Gross profit margin, net profit and return on equity.

After the data has been collected from the field it was processed and analyzed as laid down in the research plan. The researcher applied statistical tools such as bar charts, tables and graph to analyze the data gathered from the field. Descriptive statistics such as frequency distribution, Percentages, variations and measures of central tendency were used to summarize basic features of the data in the study. Inferential statistics were used to infer the sample results to the population. The statistical package for social sciences (SPSS) version 18 was used to perform the analysis of quantitative data. Regression analysis was used to assess the strength of the relationship between the independent variable on the depended variable. The regression equation that used is as shown below,

$Y = a + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \beta_5 x_5 + \varepsilon$`

Where Y=SME financial performance as measured by profit before tax divided by average assets.

a = Regression constant

X_1= Bank credit as measured by the amount of loan issued to the entrepreneur.

X_2= Age of the firm as measured by the numbers of years in operation.

X_3= Productivity as measured by output (sales) divided by the input (purchases)

X_4= Firm size as measured by the number of employees in the firm.

β = Coefficient of bank credit

ε = Error term

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter discussed the interpretation and presentation of the study findings. The purpose of the study was to determine the effects of bank credit on financial performance of small and medium enterprises in Dagoreti North Constituency.

4.2 Response Rate

This study distributed forty (40) questionnaires to the target population out these 32 questionnaires were filled and returned representing an 80% turn out. According to Mugenda and Mugenda (2003) this response rate was fair and representative since it surpasses the 50% threshold for analysis and reporting, a response rate of 60% is good while 70% and over is very good. The good turn up can be attributed to the data collection procedures, where the researcher notified potential participants in advance and utilized self administered questionnaires in which respondents completed and the same was picked shortly. In addition follow up was made when some respondents delayed in handing over the questionnaires.

Table 4.2 Response Rate

Category	No of Questionnaires	Percentage
Questionnaires Returned	32	80
Questionnaires not returned	8	20

4.3 Data Validity

The researcher conducted a pretest in order to determine the validity of the research instrument in relation to successful strategic change implementation on the four variables.

The variables were rated on the scale of 1 (very relevant) to 4 (not relevant). Validity was determined through application of content validity index. The content validity index was obtained by summing up the items rated 3 and 4 by the researcher and dividing this sum by the total number of items in the questionnaire. A content validity index of 0.716 to 0.84 was obtained. Oso and Onen (2009), states that a validity coefficient of at least 0.70 is acceptable in research hence adoption of the research instrument was valid for this study.

The research instrument contained likert scale items that were to be responded to. Thus for reliability analysis Cronbach's Alpha was calculated using SPSS. The value of the alpha coefficient ranges from 0 to1and may be used to describe the reliability of factors extracted from dichotomous questionnaires (that is questions with two probable answers) and or midpoint formatted questionnaires or scales (i.e., rating 1=strongly agree, 5=strongly disagree). A higher value shows a more reliable generated scale. Cooper and Schindler (2008) stated that a coefficient value of 0.7 is acceptable. The pilot study involved questionnaires administered to eight respondents. Since the alpha coefficients were greater than 0.7, a conclusion was drawn that the instruments had an acceptable reliability coefficient and thus appropriate for the study.

Table 4.1Reliability Test-Cronbach's Alpha

Variables	Cronbach's Alpha	Items
Capital Resources	.840	4
Firm Size	.771	5
Age of the Firm	.723	4
Technology	.716	4
Productivity	.705	4
Management skills	.742	4

4.4 Descriptive Statistics

The study sought to establish the demographic characteristics of the respondents by enquiring about their gender and education level. This was necessary in order to have a representative sample that is unbiased. Analysis of this information was presented in graphs as follows;

4.4.1 Gender of Respondents

The study sought to determine the gender representation of the respondents, this was important as it ensured adequate representation that is not biased. The results were presented in figure 4.1below

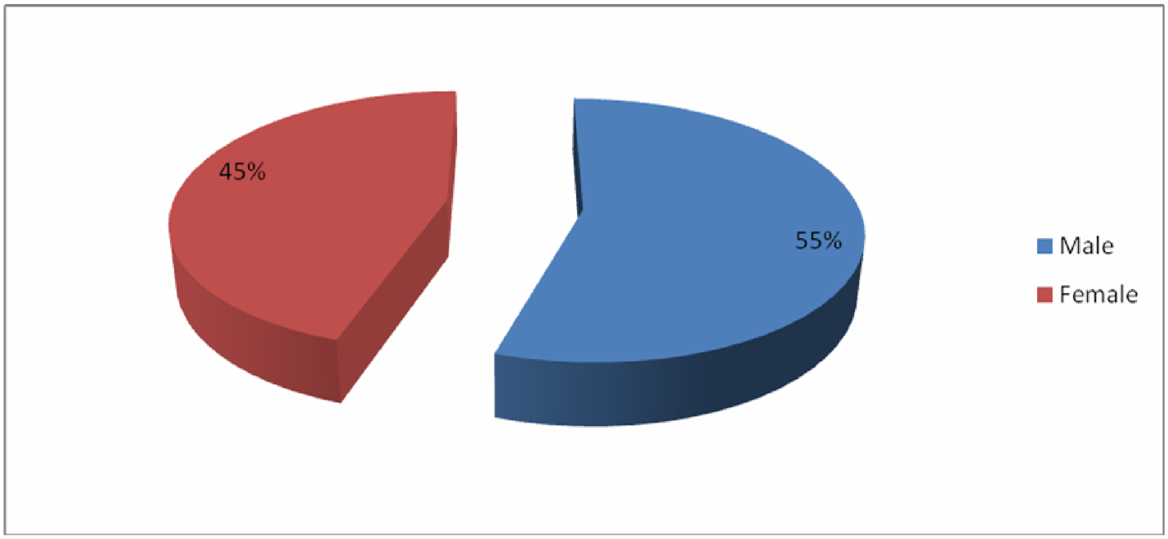

Figure 4.1Gender of Respondents

The study sought to establish the gender of the respondents and obtained the results presented in the above pie chart. From these results male respondents were 55 percent compared to female who were slightly lower by 10 percent, at 45% this indicates that majority of respondents in this study were men.

4.4.2 Highest Education Level

On the question of Highest Education Level of the respondents the study categorized education level into three levels namely; high school, college diploma, undergraduate and master's level the results were as follows:

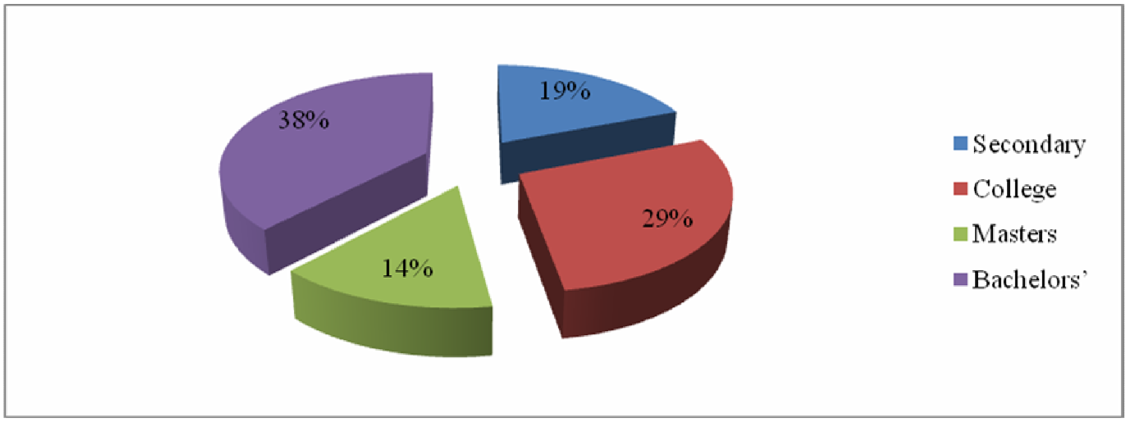

Figure 1.2 Highest Education Level

The researcher enquired from the respondents about their education level results obtained were tabulated as illustrated in figure 4.2 from the results presented it is evident that majority of respondents have Bachelors degree at 39% percent followed by those with college diplomas at 29 percent while those with secondary education certificate at 19% percent and the rest 14% have Masters qualification. Therefore majority of respondents for this study have at least first degree qualification.

4.4.3 Effects of Credit on performance of SMEs

The study sought to establish whether respondents had taken a loan for the last 3 years 63% indicated that they have accessed credit of Ksh Below 1M followed by those who had accessed 2M-5M worth of credit at 25% while the rest 12% have taken loans worth over Ksh 6m. This indicates that small and medium enterprises have the capability to take loans for their business expansion.

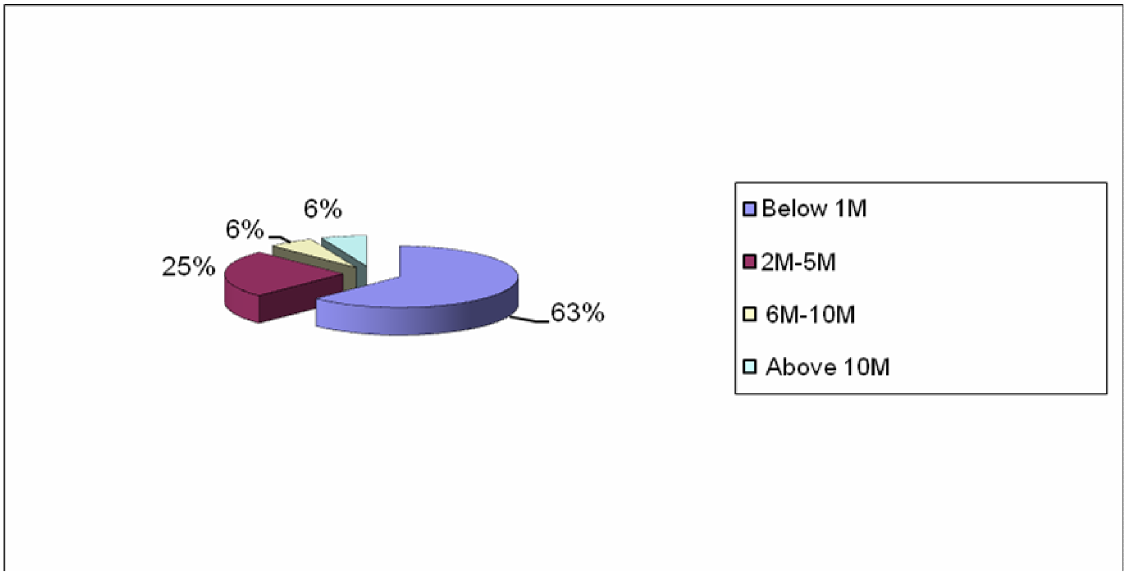

Figure 4.2 Amount of bank credit

4.4.4 Effects of Capital Resources on Performance

The study sought to determine whether availability of capital resources influence SMEs performance, on a likert scale of 1-5 (strongly agree to strongly disagree) the results are presented as follows;

Table 4.1 Effects of Capital Resources on Performance

Statements	Mean	SD	Min	Max	Med
Availability of Capital resources enhances productivity	1.201	0.423	1	4	2
Capital resources enhance profitability	1.454	0.573	1	5	1
Capital resources Enhance efficiency	1.864	0.642	1	5	3
Capital resources are easily accessible	3.234	1.432	1	5	4
The cost of capital resources is moderate/affordable	3.456	1.638	1	5	2

From table 4.2 it's evident that majority of respondents agreed that application of capital resources enhances productivity among small and medium enterprises with a mean of 1.201. on the other hand on whether capital resources enhances efficiency majority agree with a mean of 1.454 while on whether capital resources enhance efficiency the mean was 1.864. On whether capital resources are easily accessible majority of respondents neither agreed nor disagreed with a mean response of 3.234 which was replicated on the affordability of credit. These results show that availability of credit among small and medium enterprises is critical for their development however this is usually hampered by the inaccessibility of credit.

4.4.5 Firm Size

The study sought to determine the effects of firm size and its ability to acquire funding and how this affects its performance. In order to ascertain the size of the firm the study enquired on three major parameters including asset value, number of employees and annual turnover. The results are presented as below;

Table 4.2 Number of Employees

Category	Frequency	Percentage (%)
1 to 10	14	44
11 to 20	8	25
21-40	5	16
41-50	3	9
Above 50	2	6

From table 4.3 it's evident that majority of SMEs (44%) have 1-10 employees followed by those with 11-20 staff members at 25%. SMEs with 21-40 employees came third with 16%, followed by SMEs with 41-50 employees and lastly the least was SMEs with more than 50 workers. These results indicate that majority of SMEs have less than 10 employees an indication that their sheer size and capacity only allow for fewer employees.

Table 4.3 Assets in Millions

Category	Frequency	Percentage (%)
Below 1M	16	50
1M-5M	8	25
6M-10M	4	13
11M-19M	2	6
Above 20	2	6

Table 4.4 illustrates the value of assets held by SMEs in the study from the results half (50%) of respondents indicated that they have less than 1Million worth of assets followed by SMEs with 1M-5Million of assets representing 25% while SMEs with net assets of 6M-10M were 16% and the rest 11M-19M and above 20 million were the least.

Table 4.4 Sales Turnover

Category	Frequency	Percentage (%)
Below 1M	14	44
2M-5M	10	31
6M-10M	4	13
11M-15M	3	9
16M-20M	1	3

Table 4.5 indicates that majority of SMEs had sales turnover of below 1Million followed by those with sales between 2m to 5million (Ksh). Those with sales turnover of 6m-10M were 13% while 11m-15m and 16m-20m followed at 9% and 3% respectively. This shows that majority of SMEs make sales below 1million Ksh which is supported by the volume of assets analyzed in table 4.4 which confirmed that majority (50%) have assets

valued at less than 1 million. Small and Medium business constitute the very foundation upon which the large businesses were built, however, small and medium have been identified differently by various individuals and organization such that an enterprise that is considered small and medium in one place is seen differently in another. Even within a country, the definition changes over time. Although, the pro-SME view argues that small firms are more innovative than large firms; the micro economic evidence is at best inconclusive. Acs and Andretch (1987) found that small firms have higher innovation rates in high technology, capital intensive industries. For instance, Schivardi (2001) study on European industries show a larger average firm size is associated with faster innovation rates.

4.4.6 Effects of Technology on Performance of SMEs

The study sought to establish the Effects of Technology on the Performance of small and medium enterprises and the results presented as follows;

Table 4.5 Effects of Technology on Performance of SMEs

Statement	Mean	S D	Min	Max	Med
Use of technology enhances the chance of acquiring credit	1.245	0.684	1	4	2
Availability of credit has enhanced NPD	1.046	0.543	1	4	3
Technology has enhanced operational efficiency for SMEs	2.567	0.854	1	5	1
Advancements in technology has enhanced credit access	1.224	0.644	1	5	4

Table 4.6 illustrates respondents view on technology and its influence on performance. The results show that majority of respondents strongly agreed that application of

technology enhances SMEs chance of acquiring credit from financial institutions with a score of 1.245, on the other hand majority of respondents affirmed that credit access to SMEs enhances their capability to develop new products which in turn is reflected in their performance.

4.4.7 Effects of Management Skills on Performance of SMEs

On whether management entrepreneurial skills influence SMEs capability to acquire credit the study obtained the following results;

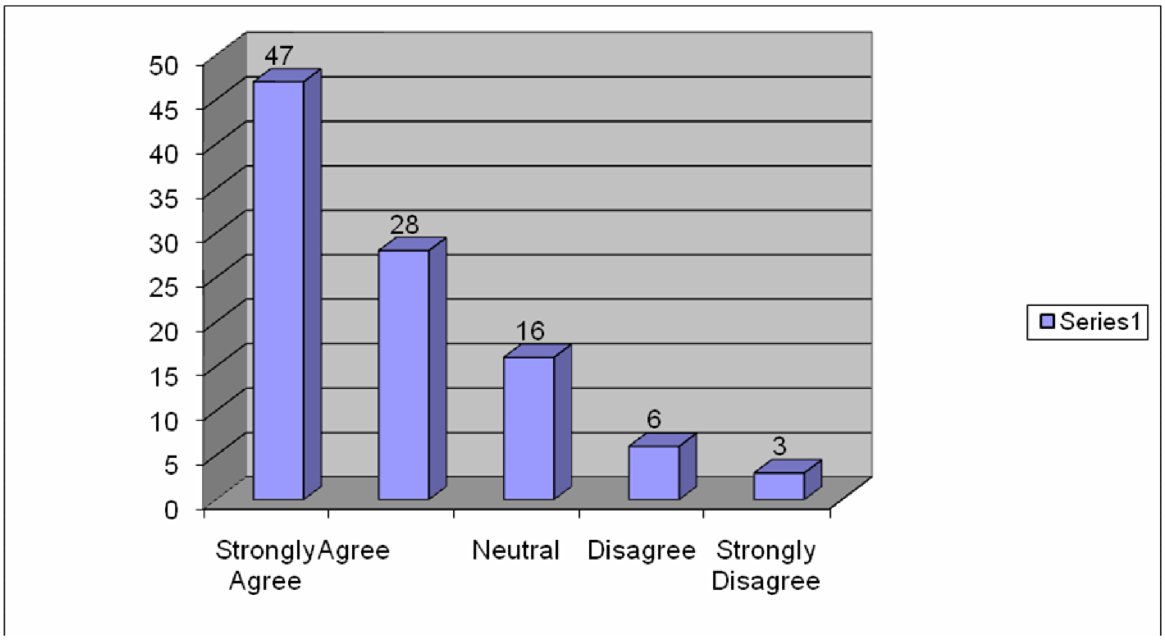

Figure 4.3 Effects of Management Skills on Performance of SMEs

Figure 4.2 shows that majority of respondents (75%) agreed that management entrepreneurial Skills influence Performance of SMEs, while 16% were indifferent on the same. The rest of respondents representing 9% disagreed with the statement. Overall it’s evident that manager’s entrepreneurial skills greatly influence ability of small and medium enterprises to acquire credit from financial institutions.

4.5 Correlation Analysis

The study carried out partial correlation to determine the association of the independent variables under study; the results are presented in table 4.6 where significance level is at 5% 2-tailed

Table 4.6 Analysis of SMES Responses

	Performance (Y)	Technology (X1)	Management Skills (X2)	Productivity (X3)	Firm Size (X4)
Wembe Artisans	1	1	3	1	1
Umeme Shades	2	2	1	2	1
Ustawi supplies	1	1	2	2	4
Spinners Traders	4	1	1	1	1
Smart Merchants	1	1	1	2	2
Sisdo Traders	4	1	2	2	1
Opportunity Kenya Ltd	1	2	1	1	1
Merchant Capital	1	1	4	1	2
Kadet Ltd	1	1	2	4	2
Jitegemee Trust	4	1	4	3	3
Fusion Supplies	1	1	5	4	1
Finikiwa Traders	1	1	4	2	5
Eurocrest Traders	2	2	1	4	2
Dagoretti Curios	5	1	1	1	4
Crossbridge Supplies	1	1	4	1	1
Bamboo Traders	1	1	1	2	2
Ushirika Artisans	1	1	1	2	3
Ufanisi Suppliers	2	1	4	2	2
Southlands Restaurant	4	1	1	2	1
Jambo Supplies	3	1	2	1	2
Upendo Milk Suppliers	1	1	1	1	1
Crayon Rural traders	1	2	4	2	1
Disneys Traders	2	1	1	1	2
DKM Contractors	1	1	1	2	2
Amani Decorators	2	3	2	1	1
Muungano curios	1	1	1	4	1
Kagemi Artisans	1	1	1	2	4
Dagoretti Juakali Traders	1	2	1	4	3
Joska Printers	1	1	1	5	4
Prism Stationers	1	1	1	4	2
Sokoni Cyber	1	1	2	1	4
Ummoja Farmcare	4	1	1	1	4
Millenium Fries	4	2	1	4	1
Kiriti Electricals	4	1	1	2	2
Faida Retailers	2	1	1	4	3
Primier Motor Vehicle Repairs	4	1	1	5	1
Ufunuo Car Wash	2	1	1	4	1
Jasma Medical Supplies	4	2	2	1	5
Andy Meat Supplies	1	1	1	4	2
Mean	**2.025**	**1.225**	**1.775**	**2.325**	**2.150**
Minimum	**1**	**1**	**1**	**1**	**1**
Maximum	**5**	**5**	**5**	**5**	**5**
Median	**3.500**	**1.000**	**1.500**	**1.500**	**1.500**

S.D		1.310	0.480	1.259	1.320	1.051

Table 4.7 Correlation Analysis

	Performance (Y)	Capital Resources (X_1)	Technology (X_2)	Management skills (X_3)	Productivity (X_4)	Firm Size (X_5)
Performance (Y)	1					
Capital Resources (X_1)	0.789	1				
Technology (X_2)	0.671	0.881	1			
Management skills (X_3)	0.567	-0.077	-0.389	1		
Productivity (X_4)	0.571	0.401	0.648	-0.655	1	
Firm Size (X_5)	0.787	-0.067	-0.389	0.512	-0.475	1

a. Predictors: (Constant), Capital Resources, Technology, Management skills, Productivity, Age and size of the Firm b. Dependent Variable: Performance

Significance 5%

Table 4.6 illustrates the correlation among the dependent variables as well as the independent variables. The results indicate that dependent variable (performance) has a significant strong positive relationship of 0.881 with the independent (capital resources) the p-value is less than 5% at 0.002. Further Technology is positively significant at 5% p=0.001with a value of 0.671 which shows that there exists a linear positive relationship between the dependent variable and the independent variable. The association of the dependent variable (performance) and management skills is also significant at p=0.002 with a coefficient of 0.571 indicating a moderate relationship with the dependent variable. Lastly firm size is also significant at p=0.002 with a coefficient of 0.787

indicating a strong positive relationship between the dependent variable and the independent variable.

4.6 Regression Analysis and Hypothesis Testing

This section presents discussion of the results of inferential statistics. Regression analysis was undertaken in order to determine the effects of bank credit on financial performance of small and medium enterprises. In order to ascertain the associations and effects of Capital Resources, Technology, Management skills, Age and size of the Firm regression analysis was carried out and results summarized in table 4.6 below;

Table 4.8 Model Summary

Model	R	R-Square	Std. Error	Sig
1	.892	0.796	0.494	.001

a. Predictors: (Constant), Capital Resources, Technology, Management skills, Productivity, Age and size of the Firm

b. Dependent Variable: Performance

Table 4.6 illustrates the model summary results. It's evident that the four independent variables can predict 89.2% of the variations in the dependent variable (SMEs performance). Likewise the coefficient of determination denoted (R^2) explains the extent of variation in the dependent variable (Performance) as explained by the four independent variables (Capital Resources, Technology, Productivity, Management skills, Age and size of the Firm). Table 4.7 above illustrates the results of the four independent variables that were studied. The four variables explain 79.6% of variance in SMEs performance as represented by the R^2 this indicates good fit of the regression equation it also implies that other factors not studied in this research contribute 20.4% of variance in the dependent variable. Consequently, further research can be conducted to investigate into the other factors that influence performance of small and medium enterprises.

Table 4.9 ANOVA

Model	**Sum of Squares**	**df**	**Mean Square**	**F**	**Sig**
Regression	4.294	4	1.246	9	0.001
Residual	1.493	8	0.486		
Total	**5.787**	**12**			

a. Predictors: (Constant), Capital Resources, Technology, Management skills, Age and size of the Firm

b. Dependent Variable: Performance

Table 4.8 above illustrates the ANOVA results regressing the independent variables against the dependent variable (Performance) gives a significant model in prediction given an F-significance value of 0.001. The F critical at 5% significance level was 3.54. Since F calculated is greater than the calculated F-critical (value=9.0), this shows that the overall model was significant. The significance was less than 5%, demonstrating that the predictor variables, (Capital Resources, Technology, Productivity, Management skills, Age and size of the Firm) are significant.

Table 4.10 Regression Analysis

Independent Variables	Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	Sig.
(Constant)	3.564	0.521	.	0.000
Capital Resources	0.865	0.687	.985	0.001
Technology	0.724	0.586	.314	0.002
Management Skills	0.468	0.502	.822	0.005
Firm Size	0.698	0.544	.277	0.003
Productivity	0.624	0.763	.456	0.004

a. Predictors: (Constant), Capital Resources, Technology, Management skills, size of the Firm b. Dependent Variable: Performance Significance at 5%

The study applied regression analysis to determine the correlation between the independent variables and the dependent variable. Earlier studies by Yartey (2008) and Lazaridis and Trofornidis (2006) applied regression analysis while researching on relationship among variables. The regression model below was used establish the association between the independent variables and the dependent variable. From table 4.9 the variables are statistically significant implying that the independent variables have an impact on SMEs performance. From the regression results, the equation is presented as follows;

$Y=a +â_1X_1+â_2X_2+ â_3X_3+ â_4X_4 + â_5X_5 + å`$

$Y= 3.564+ 0.865 X_1+ 0.724X_2+ 0.468X_3+0.698X_4+0.624X_5$

Table 4.9 represents the regression model. Taking all factors constant (Performance Capital Resources, Technology, Productivity, Management skills, Age and size of the Firm) at zero, Performance will be 3.564. The results also show that Capital Resources was significant at p=0.01 with a unit increase in the dependent variable resulting to a 0.865 increase in Performance; a unit increase in Technology will lead to a 0.724 increase in Performance; a unit increase in Management Skills will lead to a 0.468 increase in Performance and a unit increase in Firm size will lead to a 0.698 in performance. This means that the most significant factor was capital resources followed by technology while Management skills had the least impact on the dependent variable.

4.7 Discussion of Research Findings

Access to credit was found to contribute greatly to SMEs growth. This could be out of the fact that unlike established companies, most SMEs do not have goodwill with banks and therefore, their access to financing is limited due to lack of collateral and previous history. The study recommends for establishment of a fund that would be advancing subsidized credit to SMEs. This will deal with the two issues hindering SMEs access to credit for SMEs, namely; high cost of finance and collateral.

Further this study established that firm size greatly influence SMEs access to credit which eventually affect their performance. Table 4.3 shows that majority of SMEs (44%) have 1-10 an indication that their sheer size and capacity only allow for fewer employees. Lack of collateral was also observed to be a key hindrance to young SMEs in accessing credit. These findings were in line with findings by Waweru, (2012) that cost of finance in Kenya is still high therefore hindering SMEs' access to financing. Small enterprises tend to have difficulties when accessing finance from financiers due to their inability to meet certain thresholds as provided by the lenders. Inability by SMEs to access credit hinders their growth and development thus preventing such enterprises from realizing their full potential.

On whether technology influence credit access the study found out that financial innovations have a great positive influence the growth of SMEs in Nairobi County. According to the findings of the study, financial innovation, which is an element of financial deepening, can be a key lever for the growth of SMEs in Kenya. Table 4.6 show that majority of respondents strongly agreed that application of technology enhances SMEs chance of acquiring credit from financial institutions with a score of 1.245, on the other hand majority of respondents affirmed that credit access to SMEs enhances their capability to develop new products which in turn is reflected in their performance.

On whether management entrepreneurial Skills influence Performance of SMEs Figure 4.2 shows that majority of respondents (75%) agreed that management entrepreneurial Skills influence Performance of SMEs, while 16% were indifferent on the same. The rest of respondents representing 9% disagreed with the statement. Overall it's evident that manager's entrepreneurial skills greatly influence ability of small and medium enterprises to acquire credit from financial institutions. Entrepreneurial skills of owners enterprise is significant in propelling any business venture to success when such skills and or ideas are utilized correctly.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter depicts the summary of the data findings on the effects of bank credit on financial performance of small and medium enterprises. This section presents the conclusions, recommendations as well as suggestions for future research.

5.2 Summary of Findings

The study found that availability of capital resources is important in enhancing small and medium enterprise performance with respondents agreeing that availability of Capital resources enhances productivity. Further capital resources are important in wealth creation and thus access to capital by SMEs is essential in improving their performance.

On whether firm size influence availability of credit to small and medium enterprises the study found that small firms have a high growth rate fuelled by a high rates of innovation. However small and medium enterprises face a number of challenges in acquiring credit from financial institutions owing to their inability to meet the conditions as required by financiers.

On whether technology on influence performance of SMEs the study found that majority of respondents strongly agreed that application of technology enhances SMEs chance of acquiring credit from financial institutions with a score of 1.245. Further the regression results show that there exists a strong positive relationship between technology application and performance of SMEs.

Further the study found that Managers entrepreneurial skills influence their ability to acquire credit from financiers and hence affect their performance. Manager’s level of risk taking may determine whether the firm will go for credit financing or not. For small and medium enterprises to grow in terms of performance the owner or manager ought to be risk takers as they seek strategies for expansion.

5.3 Conclusion

This study established that credit access positively influences the growth of Small and Medium sized Enterprises in Kenya (SMEs). However, access to credit was found to have become easier over the last four years due to increased number of financial institutions leading to more competition and improved financial products and processes.

The study found out that financial innovations have a great positive influence the growth of SMEs in Kenya. According to the findings of the study, financial innovation, which is an element of financial deepening, can be a key lever for the growth of SMEs in Kenya. 94% strongly agreed that new processes in financial sector contributed positively to SMEs growth.

Majority of respondents affirmed capital resources is a key ingredient towards small and medium enterprise performance in terms of profitability as capital resources are key components in the production of goods and services. In order to stimulate growth in the SMEs sector concerned parties should ensure that small and medium enterprises have access to credit which is important for growth and expansion.

The ability of small and medium enterprises to access credit was found to be a significant ingredient towards SMEs growth. This could be out of the fact that unlike established companies, most SMEs do not have goodwill with banks and therefore, their access to financing is limited due to lack of collateral and previous history. The study recommends for establishment of a fund that would be advancing subsidized credit to SMEs. This will deal with the key issues hindering SMEs access to credit, namely; high cost of finance and availability of required collateral.

Further this study found that firm size greatly influence SMEs access to credit which eventually affect their performance. Majority of SMEs have less than ten (10) employees an indication that their sheer size and capacity only allow for fewer employees. Lack of collateral was also observed to be a key hindrance to young SMEs in accessing credit.

5.4 Recommendations

Most small business entrepreneurs are ignorant about MFIs. MFIs should create more awareness to the public so that those who need assistance may seek their services. This awareness can be created through the mass and electronic media such as television, radio and internet. Other methods include seminars, workshops, leaflet distribution and public rallies. They should expand their activities in order to reach out and assist more SMEs to foster growth in this young and important industry and restructure their loan programs from group-based loan schemes to individual based loans schemes, which are easier to access. This is because with the current economic hardships, it is difficult to get groups to guarantee loans for individuals.

Since the age of an enterprise is important in accessing credit, short life expectancy of SMEs especially informal ones is an impediment to credit access. High mortality rates mean lost opportunities not only of accumulating business experience but also for building credibility and reputation necessary for accessing credit from financial institutions and suppliers of inputs and products. It is therefore necessary to put in place business ‘clinics’ for extending managerial and financial aid to “ailing” businesses.

Access to credit was found to contribute greatly to SMEs growth. This could be out of the fact that unlike established companies, most SMEs do not have goodwill with banks and therefore, their access to financing is limited due to lack of collateral and previous history. The study recommends for establishment of a fund that would be advancing subsidized credit to SMEs. This will deal with the two issues hindering SMEs access to credit for SMEs, namely; high cost of finance and collateral.

5.5 Limitations of the Study

This study could not have been completed without any hindrance which emanated mainly from the subjects of the study. This was due to respondents hesitant to provide information regarding credit availability together with other information sought by the researcher due to the confidentiality of information sought. Such information was crucial to the study however to mitigate against this the researcher obtained an authorization letter from the university to collect data. Further the researcher did not coerce or force respondents to offer information but only got information from willing respondents.

Further owing to time and resource constraints the study focused on a certain target population (SMEs in Dagoretti constituency). This could limit the study in some way;

however the researcher ensured adequate representation for all respondents who participated in the study by applying an all inclusive sampling technique.

Brynard, and Hanekom (1997) states that research should be manageable in order to focus on a specific problem taking into account available time, finance, sample size and the abilities of the researcher. Even though the study adopted a combined research method, statistical methods based hypothesis testing is not carried out in this research and the research only focused on reviewing the effects of bank credit on financial performance of small and medium enterprises. The results obtained in this research would serve as a basis for future studies on this topic.

5.6 Suggestions for Further Research

Because of the limited time and funds, it was not possible to cover effectively all the areas of interest in the study and therefore more research is needed on the following area; the effect of increased credit products on growth of small and medium enterprises in Kenya. Secondly further research can also be done to determine the effect of Central Bank Base Rate (KBBR) on access of credit by SMEs.

Owing to the increased use of mobile telephony in business transactions it is expected this has contributed immensely in transforming small and medium enterprise operations hence, future research could also be undertaken to determine the effects of mobile penetration on small and medium enterprises performance.

Because of the limited time and funds, it was not possible to cover effectively all the areas of interest in the study and therefore more research is needed on the following

areas; the effect of high cost of living on the expansion of small and medium enterprises, the impact of market forces on interest rates. This will go a long way in widening the knowledge in this area and will offer more literature to future researchers. Lastly, the research only explored the effect of increased credit products on growth of small and medium enterprises in Kenya whose findings might not be similar to other sectors of the economy in different areas. Other research need to be conducted in other sectors and areas to compare and corroborate the results of this study.

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APPENDICES

Appendix I

Questionnaire for small and medium entrepreneurs

This is to obtain research data for project writing at the University of Nairobi. It is for statistical data only and will be held in strict confidence.

Instruction:

a) Read the questions carefully before ticking or filing the blank space provided

b) Do not write your name anywhere in this questionnaire

c) Answer all the questions given below

Section A- Personal information

1) Age,20-30 ☐ 31-40 ☐ 41-50 ☐ 51-60 ☐

2) Gender, ☐ Male ☐ Female

3) Level of education,

Secondary ☐

College ☐

Bachelor Degree ☐

Masters ☐

4) Number of years in operation

Below 5Years 6-10 Years 11-15 Years 16-20 Years Above 20 Years

Section B-General information

5) Did you receive bank credit on or before? If so, what was the amount of bank credit? _________Kshs.

Below 1M 2M-5M 6M-10M Above 10M

Effects of Capital Resources on Performance

Statements	**1**	**2**	**3**	**4**	**5**
Availability of Capital resources increases productivity					
Capital resources enhance profitability					
Capital resources Enhance efficiency					
Capital resources are easily accessible					
The cost of capital resources is moderate/affordable					

6). What is the size of your business in terms of: (Optional)

Employees

☐ 1-10 ☐ 11-20 ☐ -40 ☐ 50 ☐ bove 50

7). What was the size of the firm in terms of the following parameters and periods

Statement	**2011**	**2012**	**2013**
What were your total purchases in the following years			
What was the profit before tax in the following years			
Value of Assets			
Sales/Turnover			

Effects of Technology on Performance

8) Has your firm introduced new technology in the last 3 years)?

Yes ☐ No ☐

Statement	**1**	**2**	**3**	**4**	**5**
Use of technology enhanced the chance of acquiring credit					
Availability of credit has enhanced NPD					
Technology has enhanced operational efficiency for SMEs					
Advancements in technology has enhanced credit access					

9). Do you agree that Managers entrepreneurial Skills influence SMEs ability to acquire credit?

☐ Strongly Agree ☐ Agree ☐ Disagree

☐ Neutral ☐ Strongly Disagree

Appendix II: Analysis of SMES Responses

	Performance (Y)	Technology (X1)	Management Skills (X2)	Productivity (X3)	Firm Size (X4)
Wembe Artisans	1	1	3	1	1
Umeme Shades	2	2	1	2	1
Ustawi supplies	1	1	2	2	4
Spinners Traders	4	1	1	1	1
Smart Merchants	1	1	1	2	2
Sisdo Traders	4	1	2	2	1
Opportunity Kenya Ltd	1	2	1	1	1
Merchant Capital	1	1	4	1	2
Kadet Ltd	1	1	2	4	2
Jitegemee Trust	4	1	4	3	3
Fusion Supplies	1	1	5	4	1
Finikiwa Traders	1	1	4	2	5
Eurocrest Traders	2	2	1	4	2
Dagoretti Curios	5	1	1	1	4
Crossbridge Supplies	1	1	4	1	1
Bamboo Traders	1	1	1	2	2
Ushirika Artisans	1	1	1	2	3
Ufanisi Suppliers	2	1	4	2	2
Southlands Restaurant	4	1	1	2	1
Jambo Supplies	3	1	2	1	2
Upendo Milk Suppliers	1	1	1	1	1
Crayon Rural traders	1	2	4	2	1
Disneys Traders	2	1	1	1	2
DKM Contractors	1	1	1	2	2
Amani Decorators	2	3	2	1	1
Muungano curios	1	1	1	4	1
Kagemi Artisans	1	1	1	2	4
Dagoretti Juakali Traders	1	2	1	4	3
Joska Printers	1	1	1	5	4
Prism Stationers	1	1	1	4	2
Sokoni Cyber	1	1	2	1	4
Ummoja Farmcare	4	1	1	1	4
Millenium Fries	4	2	1	4	1
Kiriti Electricals	4	1	1	2	2
Faida Retailers	2	1	1	4	3
Primier Motor Vehicle Repairs	4	1	1	5	1
Ufunuo Car Wash	2	1	1	4	1
Jasma Medical Supplies	4	2	2	1	5
Jamuhuri Curio Arts	2	1	1	1	1
Andy Meat Supplies	1	1	1	4	2
Mean	**2.025**	**1.225**	**1.775**	**2.325**	**2.150**
Minimum	**1**	**1**	**1**	**1**	**1**
Maximum	**5**	**5**	**5**	**5**	**5**
Median	**3.500**	**1.000**	**1.500**	**1.500**	**1.500**
S.D	**1.310**	**0.480**	**1.259**	**1.320**	**1.051**

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DATE 02/09/2014

TO WHOM IT MAY CONCERN

The bearer of this letter PHILIP NGUTHU MULWA

Registration No. D61/84423/2012

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/~~her~~ collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

02 SEP 2014

PATRICK NYABUTO
MBA ADMINISTRATOR
SCHOOL OF BUSINESS

0723790439

UNIVERSITY OF NAIROBI

SCHOOL OF BUSINESS

PROPOSAL CORRECTION FORM

Student Name…PHILIP NGUTHU MULWA……………………

Registration Number……D61/84423/2012………………………………

Department……FINANCE AND ACCOUNTING…………

Specialization……FINANCE…………………………………………………

Title of Project Proposal….THE EFFECT OF BANK CREDIT ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN DAGORETI NORTH CONSTITUENCY………..

The student has done all the corrections as suggested during the Proposal Presentation and can now proceed to collect data.

Name of Supervisor…MIRIE……………..Signature…………………. Date…7/9/2016