FINANCIAL CHALLENGES FACING SMALL AND MEDIUM ENTERPRISES IN KISUMU CITY, KENYA AND THEIR FINANCIAL PERFORMANCE IMPLICATIONS

BY

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DECLARATION

This research project is my original work and has not been submitted for award of a degree or any other academic award in any university.

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DEDICATION

I dedicate this project to my dear loving and caring wife, Justine, my sister Sara for their love and support that they accorded me during period of the study.

You are a pillar of strength in my life.

God bless you abundantly.

ABSTRACT

Small and medium enterprise faces a lot of challenges in their operation. These challenges range from credit rationing, insufficient finance, lack of accurate documentation, lack of collateral, regulations, and high interest rates. These challenges have a lot of impact on growth, profitability and financial innovation. The study seeks to establish financial challenges facing SMEs and their financial performance implications.

The study was conducted through cross sectional survey design with a target population of 11,844 SMEs operating in Kisumu city. Systematic sampling was done in order to come up with a representative sample to eliminate bias. The study took four (4) months and data was collected through close ended questionnaire developed in likert scale and analyzed through descriptive statistic in accordance with the objective of the study.

The study found that, lack of finance and limited access to credit, high interest rates and new laws and regulation are the major financial challenges facing SMEs in Kisumu City. These challenges have implications on growth, profitability and financial innovations. Based on the findings above, the study concluded that there are three major financial challenges facing SMEs in their operation. These financial challenges have a lot of influence in performance of SMEs. The challenges influence performance in terms of growth, profitability and financial innovation.

The study will lay a strong foundation for SMEs to better manage their financial challenges in order to improve performance in terms of growth, profitability and financial innovation. It will also assist the government to come with policy framework to mitigate challenges faced by SMEs to facilitate performance of the sector. The government should also provide policy infrastructure geared towards increasing accessibility of fund to improve survival and living standard of Kenyan citizenry.

LIST OF ACRONYMS AND ABBREVIATIONS

SMEs	Small and Medium Enterprises
ICT	Information Communication Technology
IT	Information Technology
GAAP	Generally Accepted Accounting Practice

TABLE OF CONTENT

LIST OF TABLES

LIST OF FIGURE

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Small and medium enterprises have been known to contribute greatly in economic growth of both developed and developing countries. According to Wanjohi (2010), SMEs in employment tend to be higher in developing countries. The share of SMEs in employment tends to be higher in developing countries, which are typically more focused on small scale production. As such he noted that policy provision remains fundamental in propelling these enterprises towards self sustenance and realization of their full potentials in contributing towards economic growth (Wanjohi, 2010). Larsen and Lewis (2008) noted that SMEs faces different barriers to survival, growth and innovation. They observed that majority of failures in SMEs performance were due to multiple factors such as undercapitalization, insufficient working capital, short term liquidity problems, insufficient startup capital and poor management. In Kenya for instance, SMEs operation cut across all sectors of the economy and sustain majority of households. The sector ranges from Agriculture, Manufacturing and financial sector just to mention but a few. These SMEs activities provide a breeding ground for business and employee and provide one of the most prolific sources of employment and economic growth in Kenya.

Several theories have been advanced to justify financial challenges facing SMEs and their financial performance implications. These theories are Pecking order theory advanced by Myres (1984) and Agency theory advanced by Rose and Mitnick (1973, 1973). Pecking order theory by Myres (1984) postulate that the cost of financing increase with asymmetric information. He reported that financing comes from three sources, internal funds, debt and equity. However, in case of SMEs, raising funds from security exchanges is a challenge since majority are informal and formal SMEs do not meet stringent condition required by Capital Market Authority. The Agency theory propagated by Ross and Mitnick (1973 , 1973), recognized that, the day to day running of the business enterprise is carried out by managers as agents who have been engaged by owners of the business as principles who are known as shareholders. Problems identified with agency theory include information asymmetry, moral hazard and adverse selection.

Kisumu City is the third largest City in Kenya and is the Headquarter of Kisumu County Government. It developed progressively from a railway, industrial, communication and administrative centre of Lake Victoria basin. The population of Kisumu City is estimated to be one million with a majority of employable work force engaged in small and medium enterprises programme. In Kisumu City, SMEs conduct their economic activity virtually in all sectors of the economy. These include fishing, agriculture, transport, finance, small scale artisan and manufacturing and construction.

1.1.1 Financial Challenges Facing SMEs

Joseph, Kofin, Fanyel & Gaeten (2013) noted that, access to credit is crucial for the growth and survival of small and medium sized enterprises (SMEs). They observed that policy makers attempt to pursue financial sector policies to propel financial intermediaries to extend more credit to SMEs. Access to credit still remains a challenge to SMEs, especially those in developing economies and continues to dominate discussion both within business cycle and at the corridor of various governments (Joseph et al, 2013). According to Abor and Quartey (2010), financial intermediaries that uses the asset based lending techniques looks at the underlying asset of the firm (which are taken as collateral) as a primary source of repayment. Abor and Quarley (2010) noted that, for working capital financing, banks use short term asset such as account receivable and inventory. For long term financing, they use equipment. They further noted that the pledging of collateral by itself does not distinguish asset based lending from any of the other lending technologies. Collateralization with accounts receivable, inventory and or equipment is often associated for example with financial statement lending, relationship lending and credit scoring, where collateral is used as a secondary source of payment (Abor and Quarley, 2010).

Joseph et.al. (2013) argued that financial characteristic such as business registration, accurate documentation of transaction and financial activities as well as good business planning have positive relation with credit accessibility. They observed that asset ownership constitute a great deal of requirement towards accessing credit from financial institutions as all entrepreneurs who were able to access loans said they own assets such as houses, land, business products and business vehicles which are easily used as collateral depending on the amount of credit being sought (Joseph et.al, 2013). However, access to credit was not tied completely to asset ownership (Joseph, et. al. 2013). European commission report (2013), argued that access to finance is a key determinant for business start up, development and growth for small and medium size enterprises. It reported that, they have very different needs and faces different challenges with regard to financing compared to large businesses. The report observed that lack of equity capital invested in small firms makes these businesses more irrelevant than other sources such as bank lending and other types of financial products. The current economic environment has brought SMEs needs into particular fouls given the significantly lightened credit supply condition arising from the reduced ability and willingness of banks to provide the finance on which this sector is particularly reluctant (European Commission report, 2013).

Park, Limand and Koo (2008) identified lack of adequate finance and limited access to credit, rapid technological changes, new laws and regulations and high rate of interest as the major challenges facing SMEs in their financing endeavors. The broad picture that emerges from various surveys of SMEs financing strongly suggests that business owners in South Africa views access to financing a significant problem for business activity (Turner, 2008). Turner (2008) noted that, there might be a financing gap, despite the various public and private sector initiative to facilitate access to financing. Responding to Fins cope small business survey (2010), However, when asked to identify the single most significant obstacle to growth, access to finance ranked third with 8.7% of small business owners citing lack of access to finance as a reason.

Antony (2012) argued that despite the potential role of SMEs to accelerate growth and job creation in developing countries, a number of bottlenecks affect their ability to realize their full potential. Antony (2012) observed that SMEs development is hampered by a number of factors, including finance, lack of managerial skills, equipment and technology, regulatory issue and access to international market. The fundamental reasons behind SMEs lack of access to fund can be found in their peculiar characteristics while others argued that SMEs suffer from financing gap because of market imperfection on supply side (Park, et. al, 2008). Park et. al (2008), further they argued that SMEs faces financing gaps probably because of combination of reasons originating from both supply and demand sides. The supply side refers to providers of finance (Financial institutions and investors) while the demand side is composed of SMEs who require financing from financial institutions and other providers of finance (Park et. al. 2008). The financing gap is most prominent in capital market financing. Most countries including the developed one have problems in SMEs financing through capital market (Park et. al 2008).

The effect of banking condition, monetary policy and economic growth on small business may change as economic condition changes (Hans, Fraser and Storey, 2008b). Hans et. al. (2008b) noted that if so their (and likely future) effects are likely depend on the prevailing interest rate and economic growth rate and this differs from their past average effects. They reported that to allow for the possibility that the magnitudes of these effects vary with the economic condition, they separately estimated effects for the period when monetary policy was tighter and when national economic growth was slower (Hans et. al 2008b). Indeed the estimate effects did vary considerably with interest rate and economic growth. The concept of credit rationing is important for SMEs, because the most common source of external financing for small firm is bank debt (Mole, Hart, Roper and Saal, 2008). Small firms however find it more difficult to obtain bank loans than do large firms because when they do obtain loans, it is usually at high interest rate and on more stringent terms than larger firms (Mole et al. 2008).

Access to capital market is still under developed both to SMEs and for retail lending entities that could lend them (Benhams, 2010), while direct market access poses transaction cost and liquidity problems, securitizations has significant potential for increasing access to capital and lowering the cost of capital (Benham, 2010). There are several regulatory issues that presently hinder implementation of this solution (Benham, 2010). Amanda (2012) reported that access to information is important both for the SMEs perspective and from providers of services. The SMEs require information with which to identify the potential suppliers of financial services (Amanda, 2012). They require this information to evaluate the cost of financial services that are being offered. The financial service provider also requires information which it will use to evaluate the risk of the SMEs. All these are hindered by the current laws and regulation (Amanda 2012). Amanda (2012) suggested the tradeoff between individual right to privacy balance against commercial value information.

1.1.2 Financial Performance

Financial performance is a wide concept in many areas. Usually financial performance is a measure of how well a mechanism or processes achieves its purpose. In the enterprise management, Moullin (2003) defines an organization performance as how well the organization is managed and the value the organization delivers for customer and other stakeholders. For the purposes of this study we will define financial performance as the processes geared towards achieving organizational objective and creating value for money for shareholders.

According to Moullin (2007), performance measurement is the process of collecting, analyzing and or reporting information regarding the performance of an individual, group, organization systems or component. It can involve studying processes or strategies within organization or studying engineering processes or parameters or phenomena to see whether output are in line with what was intended or should have been achieved (Moullin, 2007). Although the balance score card has become very popular, there is no single version of the model that has been universally accepted (Gamble, Strickland and Thompson, 2007).

According to Chong (2008), a business organization could measure its performance using financial and non financial measures. The financial measures include profit before tax and turnover while non-financial measures focus on issues pertaining to customer satisfaction and customer referral rates, delivery time, waiting time and employee turnover. He noted that recognizing the limitation of relying solely on either financial or non financial measures, entrepreneurs of the modern SMEs have adopted a hybrid approach of using both financial and non-financial measures. He observed that these measures serve as precursors for course of action. The study used return on equity as a measure of performance for SMEs. This is because it is a measure of efficiency of a company's capital and ensures that the enterprise is on track financially.

1.1.3 Financial Challenges Facing SMEs and Their Financial Performance Implication.

Larsen and Lewis (2008) observed that SMEs faces different barriers to survival, growth and innovation. They found that majority of failures in SMEs performance were due to multiple factors, such as under capitalization, short-term liquidity problems, Insufficient working capital, insufficient starts up capital and poor financial management. They noted that SMEs risks arise from the fact that SMEs Management is typically thinner than that of a large diversified company. However, they argued that, SMEs likely has limited management skills, international experience and infrastructure resulting in a steeper learning curve and a greater need to rely on third party organizations which can be expensive because of the relative high cost of hiring outside experts. SMEs management tends to prefer do-it-yourself approach and may hesitate to work with third parties and to invest in the necessary outside counsel and support (Ganster, 2007).

Larsen and Lewis (2007) confirmed that SMEs themselves see the real barriers to partnership to be associated with an inability to overcome marketing barriers, find suitable partners and lack of trust. Savignaci (2008) indicated that data on the SMEs sector in Kenya is scarce, although the national SME baseline survey provides comprehensives and reliable information it has not been updated since 1999, and these does not contain information for medium firms. He argued that the survey indicates that the contribution of SMEs sector to gross domestic products increases from 13.8 percent in 1993 to 18.4 percent in 1999. This shows that the government policies put in place in Kenya also do affect the growth and survival of the SMEs.

Aghio, Fally and Scarpetta (2007) characterized SMEs by two factors, they cannot issue equity and are concern about ownership and control. They noted that small firms usually do not have options of issuing additional equity to the public. Even if they were able to issue private equity, managers of SMEs would restrain from doing so as issuing equity would lead to a dilution of ownership and control (Aghio et al 2007). Aghio et al (2007) therefore identified that managers of SMEs will usually prefer to go for debt financing mainly comprising of banks financing. They observed that these constraints have a diverse effect on the growth and survival of SMEs.

Profit maximization, business growth as a component of business performance is still the major goals of business enterprises (Ekanem, 2010). Profit is desirable by the business to ensure a long term survival of the business and that's why there are many businesses start up in Uganda (Ekanem, 2010). Ekanem (2010) argued that whereas Uganda has the highest rate of business start up, it is also among the countries with the highest number of SMEs that perform poorly and close business before the end of the first year in business. Poor business performance has for long remained unexplained, most especially in the third world countries perspective where SMEs occupy the largest part of the economy (Nguyen, 2011). Nguyen (2011) cites inefficient financial management practices to contribute immensely to SMEs poor performance.

1.1.4 Small and Medium Enterprises in Kisumu City

Kisumu city is the third largest city in Kenya and is the Headquarter of Kisumu County government. It has developed progressively from a railway, industrial, communication and administrative center in Lake Victoria basin. It serves as a communication and trading confluence for the great lake region of Tanzania, Uganda, Rwanda and Burundi. It is the Headquarter of East Africa Community (County development plan, 2014). The population of Kisumu City is estimated to be one million with a majority of employable work force engaged in small and medium enterprises programme in order to survive. This means that there is need to develop a structural policy framework in order to empower SMEs to contribute towards development of economy. In Kisumu City, SMEs conduct their economic activities virtually in all sectors of the economy. These include fishing, agriculture, transport, finance, small scale artisans, manufacturing and construction.

Dakar (2011) observed that the term ''SMEs'' encompasses a broad spectrum of definition. He noted that different organizations and countries set their own guideline for defining SMEs, often based on head count, sales or asset. He argued that Egypt defines SMEs as having more than five and fewer than fifty employees. Vietnam consider SMEs to have between ten and 300 employees, World bank defines SMEs as those enterprises with a maximum of 300 employees and $15 million in annual revenue and $15 million in asset, the inter American Development Bank describes SMEs as having a maximum of 100 employees and less than $ 3million in revenue. In Kenya, sessional paper No.2 (2005) defines SMEs as an enterprise with between 1 to 50 employees. For the purpose of this study, we defined SMEs as encompasses both formal and informal sector up to and including fifty employee and have less than five million turnover sales per annum.

SMEs play a very important role in developing economy in the whole world especially to those with major employment and income distribution challenges. Palma (2005) argued that SMEs contribute to output and creation of Jobs. He further noted that they are a nursery for large firms of the future. Expanding micro enterprises contribute directly and often significantly to aggregate savings and investment, therefore SMEs is a power house that propels economies to sustainable level, create income and wealth and improve the living conditions of the citizenry through creation of employment (Palma, 2005). It is generally recognized that small and medium enterprises faces unique issues which affects their growth and profitability and hence diminish their ability to contribute effectively to sustainable development. Ohachism (2009) observed that small and medium enterprises usually operate on working capital and day to day cash management. He noted that the reserve that is available is primarily used for paying bills and source of new business.

According to Park, Limand and Koo (2008), SMEs heavily depends upon bank loans and generally experiences a financing gap even in developed countries. They noted that some SMEs suffer from financing gap because of market imperfection on the supply side and combination of reasons originating from both supply and demand sides. The researchers observed that financing gap for SMEs is most prominent in capital market financing and most countries including developed ones have problems in SMEs financing through capital markets.

1.2 Research Problems

Kenya Economic survey report (2009) indicated that there are estimated 7.5 million SMEs in Kenya, Providing employment and income generation opportunities to low income sector of the economy of this country. According to the report, this sectors contribution to gross domestic product (GDP) has increased from 13.8 percent in 1993 to about 40 percent in 2008. The SMEs sector provided approximately 50 percent of the total employment and contributed over 92% of the new jobs created in 2008 (Economic survey, 2009). The sector therefore plays a key role in employment creation, income generation and is the bedrock for industrializing the country in the near future.

Kisumu City is heavily endowed with SMEs. This sector plays a critical role in the development of Kisumu City. Their business spreads all over sectors of the economy like Jua Kali, hawkers, Provisional stores, Manufacturing, Agriculture, construction, Hospitality and fishing. Therefore, there is need to assess the financial challenges facing SMEs and their financial performance implication in Kisumu City.

Various studies has been done on SMEs to identify how best to manage their activities in order to contribute to the economic development of the nation. Karugu (2013) studied the effects of taxation on the cost of operation of Small and medium enterprises in Nairobi City. He noted that taxation imposes a great impact on cost of operation and therefore a threat to viability and growth of SMEs. Wehinger (2013) studied SMEs and the credit Crunch, current financial difficulties, policy and a review of literature. The policy measure to support SMEs lending during the crisis, and the difficulties in SMEs access to finance during the crisis against the backdrop of sharp decline in bank profitability. Pandula (2011) studied empirical investigation of small and medium enterprises access to credit from banks of Australia. The hypothesis of this study has been derived utilizing eleven factors which affects credit worthiness of SMEs. From the above review of studies made by previous researcher, it is evident that little has been done in terms of SMEs in Kisumu City. It is against this backdrop the researcher studied financial challenges facing SMEs and their financial performance implication in Kisumu City. Therefore, what are the financial challenges facing SMEs in Kisumu City and their financial performance implication?

1.3 Objective of the Study

To establish financial challenges facing SMEs, and the effects of financial challenges on performance of SMEs in Kisumu City, Kenya.

1.4 Value of the Study

The research will help the government to develop policy framework to mitigate financial challenges faced by SMEs in order to boost performance. It also helps to improve our intellectual understanding on the effects of financial challenges on performance of SMEs. Further the study may be used by SMEs to understand financial challenges on performance in order to improve on the challenges to boost performance of their business enterprises. This will enhance income per capita, economic growth and improvement in gross domestic product.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter discusses theories underpinning the study and a review of literature on the financial challenges facing SMEs and their financial performance implication.

2.2 Theories Underpinning the Study

Several theories have been advanced by scholars to support the effects of financial challenges on performance of SMEs. Some of these theories are Pecking order Theory and Agency theory.

2.2.1 Pecking Order Theory

This theory was introduced by Myers and Majluf (1984). They argued that the cost of financing increases with asymmetric information. They observed that financing of business comes from three sources, internal fund, debts and new equity. Firstly they prefer internal financing, then debt, and then raising equity as last resort. Hence internal financing is used first, when depleted, then debt is issued, and when it is no longer sensible to issue any more debt, equity is issued, this theory maintains that businesses adhere to hierarchy of financing sources and prefer internal financing when available and debt is preferred over equity if external financing is required. Thus, the form of debt firms choose can act as a signal of its need for external finance.

However SMEs rarely raise capital in security exchanges because of stringent law and regulation required by the capital market Authority. In practical application of pecking order theory in SMEs, only two levels are applicable, which is, internal fund and borrowing from financial institutions, friends, relatives and even venture capital.

2.2.2 The Agency Theory

The agency theory was introduced by Rose and Mitnick (1973, 1973), Rose (1973) introduced the study of agency theory in terms of problems of compensation contracting and Mitnick (1973) came up with the now common insight that institution form around agency and evolve to deal with agency in response to the essential imperfection of agency theory. Agency theory tries to explain a relationship between principals and agents in business. It is concerned with resolving problems that can exist in agency relationship (Pandula, 2011).

Pandula (2011) reported that agency theory deals with people who own business enterprises and all others who have interest in it. He observed that agency theory postulate that the day to day running of the business enterprises is carried by mangers as agents who have been engaged by the owners of the business as a principle who are also known as shareholders. Pandula (2011) argued that the theory is on the notion of the principle of two sided transaction which holds on any different expectation. However the problems identified by agency theory are information asymmetry, moral hazard and adverse selection (Pandula, 2011). These theories aid researchers to understand the intellectual arguments about the effects of financial challenges on performance of SMEs.

2.3 Financial Challenges facing SMEs and their financial performance implication.

Larsen and Lewis (2008) argued that SMEs faces different barriers to survival, growth and innovation. They noted that majority of failures in SMEs performance were due to multiple factors such as under capitalization, short term liquidity problems, insufficient working capital and poor financial management. They noted that SMEs risks arise from the fact that SMEs Management is typically thinner than that of a large diversified company. However they observed that SMEs likely has limited management skills, International experience and infrastructure resulting in a steeper learning curves and greater need to rely on third party organization which can be expensive.

Profit maximization, business growth and innovation as a component of business performance are still the major goals of business enterprises (Ekanem, 2010). Profit is desirable by the business to ensure a long term survival of the business and that is why there are many businesses start up.

2.3.1 Business Growth

Beck and Asli (2006) argued that splitting big firms into small firms or subsidizing small firms will not lead to faster growth. They noted that more fundamental reforms must first be instituted to tackle the underlying reasons why firms do not fulfill their growth potential. They indicated that the ability to access finance may be one of the reasons why they do not see a robust correlation between SMEs Prevalence and economic growth (Beck and Asli, 2006).

Beck and Asli (2006) further noted that financial development helps small firms the most. They noted that both firm level and industry level studies suggest that small firms do relatively better compared to large firms in countries with better developed financial institutions (Beck and Asli, 2006). Berger and Udell (2006) found that with financial development, small firms grow faster since their financing constraints are relaxed to a greater extent. Further, industrial sectors that should naturally have a disproportionately large number of small firms also grow faster with financial development, suggesting that it is the small firms that benefit the most (Berger and Udell 2006). Lack of a well functioning financial markets and underdeveloped legal system make it very difficult for firms to grow to their optimal size since outside investors cannot prevent expropriation by corporate insiders. Beck and Asil (2006) further argued that finance is important for SMEs strategies and if it is optimal for firms to stay small in countries, with underdeveloped institution, simply subsidizing SMEs may not at best ineffective, and at worst, counterproductive.

2.3.2 Profitability

Raphael and Shin (2012) noted that, while the overall credit condition has been accommodative, credit growth has remained constant especially for small and medium enterprises. Firm level data and sectoral corporate balance sheet shows that many SMEs have faced structural challenges of high leverage and low profitability (Raphael and Shin, 2006). Raphael and Shin (2006) further argued that the global financial crisis has weakened the financial position across SMEs, particularly for those with low credit worthiness. These challenges are closely related to low availability of risk capital and the pervasiveness of credit support measures (Raphael and Shin 2006). They encourage the supply of risk based capital, costly government support measures should be phased out and SMEs restructuring be accelerated. Efforts are also needed to deepen capital Market to enhance risks, capital availability and address regulatory barriers to starting a business. In that regard addressing SMEs weaknesses would improve private investment, enhance firm productivity and lift growth (Raphael and Shin, 2006).

Scarborough, Norman and Douglas (2008) indicated that SMEs can be more flexible and responsive to new market opportunity and economic recession. They noted that in the period of high unemployment, many former employees start their own enterprises, relying on their experience, education and managerial skills. Furthermore, large firms increasingly place part of their work outside the organization providing a further incentive for the creation of new small firms. Since sub contracting and outsourcing can reduce production cost (Scarborough et.al. 2008). Scarborough et.al (2008) concluded that SMEs grow and develop, they face strains on their profitability that impact on a key performance indicator return on investment (ROI). Further any deterioration in Return on Investment will compromise a firm's ability to obtain finance for future expansion.

2.3.3 Financial Innovation

Tiwari (2007) argued that advancement especially in information and communication technologies (ICT) have enhanced greatly the competition spurred by the globalization of the world economies. He further argued that even SMEs are no more immunized to the challenges that the globalization brings about (Tiwari, 2007). The finding of Innovative management policy and practice (2013) confirmed that an increase in innovative level increases financial performance, specifically; they underline the relevance of the innovation developed in order to meet the customers need as well as of those develop in order to differentiate from the competitor in improving financial performance.

Tiwari, Buse and Herslatt (2007) also observed that the innovative ideas and products are becoming increasingly important to counter the price oriented competition from low-cost producers from emerging economies (Tiwari et. al. 2007). On these crucial scores, SMEs often find themselves confronted with a number of barriers to innovation like resource constraints which hinder processes and development of innovative products (Tiwari et. al. 2007)

2.3.4 Summary of literature review

In summary, financial challenges facing small and medium enterprises are lack of adequate finance and limited access to credit, high interest rates and new laws and regulation. These factors are interconnected and intertwine in terms of policy direction and overall effectiveness in addressing SMEs financial challenges.

It was also coming up clearly that these financial challenges affects SMEs performance, it has a lot of impact on business growth, profitability and financial innovation. All these issues demand the development of a clear policy framework in order to mitigate the financial challenges and release the SMEs from the current quagmire they are facing. This will improve the overall performance of SMEs, create employment opportunity, innovative products and enhance the overall economic growth.

It was clearly observed that better financial institutions in terms of structure and policy, favorable laws and regulation improve the performance of SMEs in terms of growth. Increasing research and financial innovation due to availability of credit facilities from lenders has a positive effect on product innovation and this enhances sales and profitability. Information technology is very critical for information dissemination and for provision of competitive edge. If all these issues are consolidated and addressed through policy framework and infrastructure, the performance of SMEs will improve and this has a positive impact on the economic performance.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

Research methodology refers to the analysis of principle methods and procedure used to carry out the study. It includes research design, sample design, population, data analysis, reliability and validity and data collection methods.

3.2 Research Design

The study was based on cross sectional survey design. This design takes a snap shot of a population at certain times, allowing conclusion about phenomena across a wide population to be drawn. Cross sectional survey are sometimes carried out to investigate association between risk factor and outcome of interest (Blan, 2001).

This design was adopted because it is relatively in expensive and takes up little time to conduct the study. It can also estimate prevalence of outcome of interest because sample is usually taken from the whole population. It can allow statistical inference to the population being studied.

3.3 Population

According to Cabrell, Harwood and Matthiopoulos (2009), population is a set of entities concerning which statistical inference are to be drawn often based on a random sampling taken from the population. It also refers to a set of potential measurement or value including not only cases actually observed but also those that are potentially observable.
Kisumu County Integrated Development Plan (2014) estimates the total number of population of SMEs operating in Kisumu City to be 11,844. These entities are engaged in various sectors of economy in Kisumu City. The plan observed that, there is need for proper policy and infrastructure framework to mitigate challenges faced by SMEs within the region.

3.4 Sampling Designs

Cabrel, Hawood and Matthopoulos (2009) define sampling as the process used in statistical analysis in which a predetermined number of observations will be taken from a larger population. They observed that the methodology used to sample from a larger population will depend on type of analysis being performed, but will include random sampling, systematic sampling and observational sampling. The sample data should be representative of the whole population.

For the purpose of this study, the researcher used probability sampling to carry out the study. Simple random samplings were used because it is highly representative of the population and eliminate bias that may arise during data collection. It also simplifies data interpretation and analysis of result and has sufficient external validity. We used simple random sample in areas of Town Centre, Nyamasaria, Nyalenda, Manyatta and Jua Kali. The population of study was 11,844 out of which samples size 100 (one hundred) were selected. This was because a sample size should be 5% of the population or at least 30 samples would be a representative of the whole population of study.

3.5 Data Collection Technique

Structured close ended questionnaires developed in likert form were used to receive response from the respondents. Data was collected from formal and informal enterprises whose turnover not exceeding Sh.5 million and have less than 50 employees, we used close ended question for easy analysis and to avoid respondent digressing from the real issue of the study. Sample questionnaire was subjected to piloting test before administration. The administrator of questionnaire was appraised on how to reframe the question in case of difficulty and especially those who needs translation.

3.6 Data Reliability and Validity

Chan, Fowles and Weiner (2012) argued that the validity and reliability of data are important to determine the stability and quality of data obtained. They noted that there are no single coherent set of validity and reliability test for each research phase. The researchers observed that the techniques for judging the quality of the method are objectivity, vigorous and relevant information.

The researcher tests the reliability of sampling by pilot test questionnaire in order to gauge interpretability and understandability of the concept by the respondents. The validity of data was monitored through random sampling and administration of questionnaire at the business premises of SMEs in order to get factual information from the respondent in such a manner that any researcher would arrive at the same conclusion were he to replicate the same study.

3.7 Data Analysis Technique

Joseph (2008) argued that data analysis is the process of inspecting, cleaning, transforming and modeling of data with the goal of discovering useful information, suggested conclusion and supporting decision making. He noted that data analysis has multiple facet and approaches encompassing diverse techniques under a variety of names in different business, science and social science domain.

The study adopted descriptive analysis in accordance with the objectives of the study. In descriptive analysis, the researcher used frequency distribution, mean, median and percentage to describe the main feature of the study.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

The study seeks to identify financial challenges facing small and medium sized enterprises in Kisumu City and their financial performance implication. The study targeted 100 small and medium enterprises in areas of Nyamasaria, Nyalenda, Town Center, Jua Kali and Manyatta in Kisumu City. The study received 85 completed questionnaire analyzed using descriptive statistic in line with the objective of the study. The study adopted closed ended questionnaire developed in likert scale as a primary source of colleting the data. This chapter indicates data analysis, results and discussions.

4.2 General Information

The following relates to the personal information received from the respondents. This information includes nature of business, gender, age and highest level of education.

4.2.1 Nature of Business

Table 4.1 Nature of Business

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Food kiosk	5	5.9	5.9	5.9
	M-Pesa	2	2.4	2.4	8.2
	Cyber café	2	2.4	2.4	10.6
	Music shop	2	2.4	2.4	12.9
	Fish monger	2	2.4	2.4	15.3
	General shop	14	16.5	16.5	31.8
	Cosmetics	4	4.7	4.7	36.5
	Water	2	2.4	2.4	38.8

vender				
Butchery	2	2.4	2.4	41.2
Second hand cloths	9	10.6	10.6	51.8
Salon	3	3.5	3.5	55.3
Electronics shop	9	10.6	10.6	65.9
Laundry	1	1.2	1.2	67.1
Shoe seller	1	1.2	1.2	68.2
Grocery	4	4.7	4.7	72.9
Mechanic	3	3.5	3.5	76.5
Farming	1	1.2	1.2	77.6
Auto spares	14	16.5	16.5	94.1
Book shop	1	1.2	1.2	95.3
Chemist	2	2.4	2.4	97.6
Bar and Accommodation	1	1.2	1.2	98.8
Construction	1	1.2	1.2	100.0
Total	85	100.0	100.0	

The nature of business carried out by small and medium enterprises in Kisumu City are food kiosk with 5.9 %, M- pesa 2.4%, cyber café 2.4%, music shop 2.4%, fish monger 2.4%, general provisional stores 16.5%, cosmetics 4.7%, water vender 2.4%, butchery 2.4%, second hand cloths 10.6%, salon 3.5%, electronic shops 10.6%, laundry 1.2%, shoe dealers 1.2%, groceries 4.7%, mechanics 3.5%, farming 1.2%, auto spares 16.5%, bookshops 1.2%, chemists 2.4%, bar and accommodation 1.2% and construction 1.2% as shown in table 4.1 above.

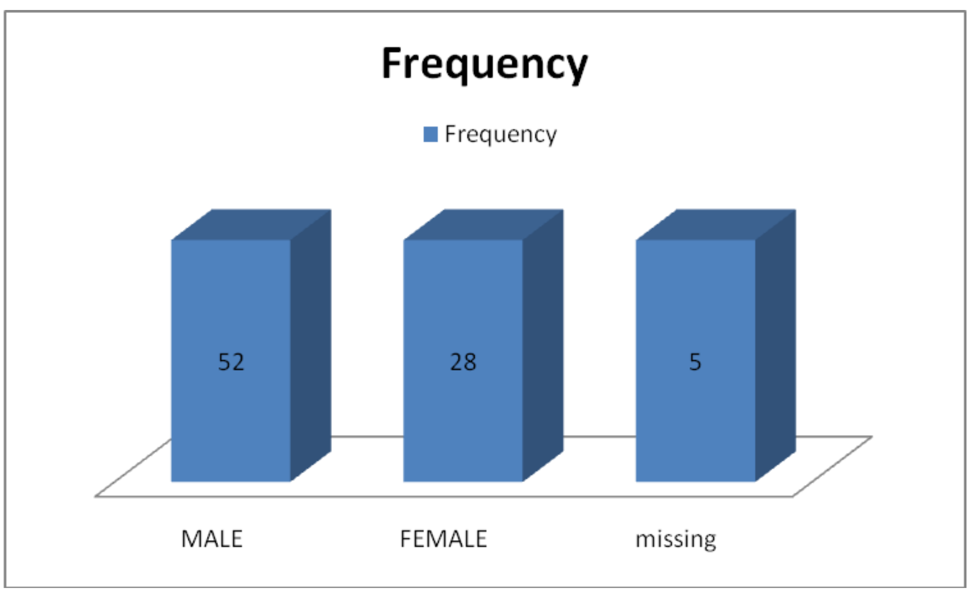
4.2.2 Gender

Table 4.2. Gender

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	MALE	52	61.2	65.0	65.0
	FEMALE	28	32.9	35.0	100.0
	Total	80	94.1	100.0	
Missing	System	5	5.9		
Total		85	100.0		

Majority of the respondent who filled questionnaire were male with 65%, while females were 35%. 5 of the respondent did not indicate there gender as shown in frequency distribution below.

Figure 4.2



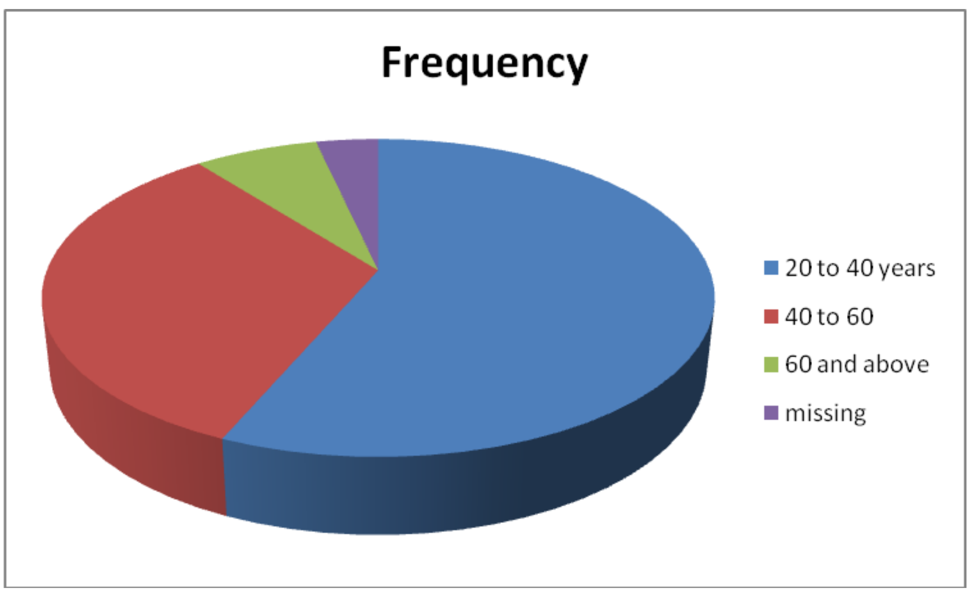
4.2.3 Age

Table 4.3: AGE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	20 to 40 years	48	56.5	58.5	58.5
	40 to 60	28	32.9	34.1	92.7
	60 and above	6	7.1	7.3	100.0
	Total	82	96.5	100.0	
Missing	System	3	3.5		
Total		85	100.0		

58.5% of the respondent indicate there age bracket to be between 20 to 40 years, 34.1% indicate there age bracket to be between 40 to 60 years and the remaining 7.3% indicate there age to above 60 years.

Figure 4.3



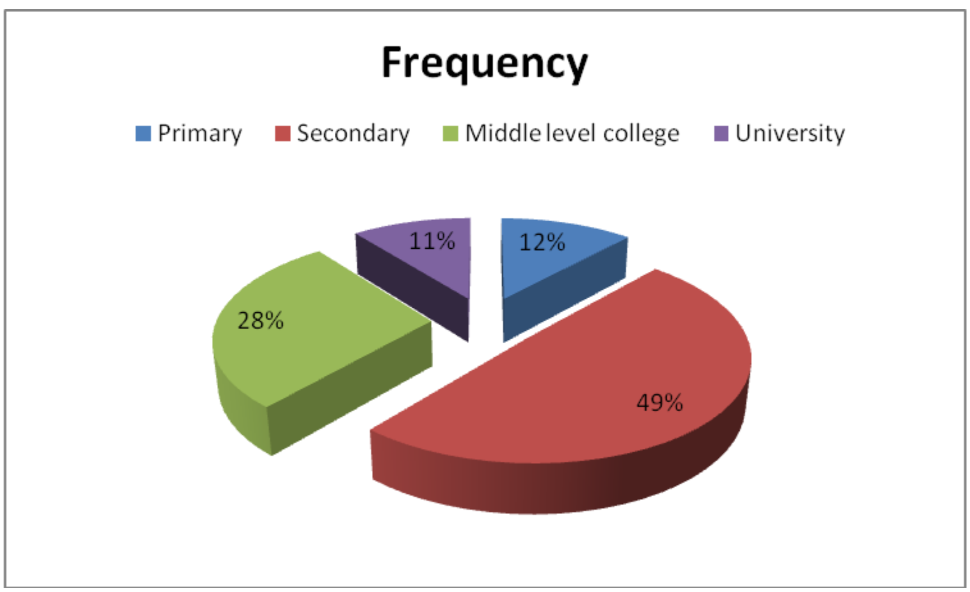
4.2.4 Highest level of education

Table 4.4: Highest level of education

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Primary	10	11.8	11.8	11.8
	Secondary	42	49.4	49.4	61.2
	Middle level college	24	28.2	28.2	89.4
	University	9	10.6	10.6	100.0
	Total	85	100.0	100.0	

According to the results from the respondent, 49.4% of the respondents attain secondary education, 28.2% middle level colleges, 10.6% University level and 11.8% managed primary education.

Figure 4.4



4.3 Financial challenges

4.3.1 Lack of adequate finance and limited access to credit

Table 4.5

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	66	77.6	77.6	77.6
	Agree	18	21.2	21.2	98.8
	Neither agree nor disagree	1	1.2	1.2	100.0
	Total	85	100.0	100.0	

Majority of the respondents strongly agree that lack of adequate finance and limited access to credit are the major financial challenges facing small and medium enterprises in Kisumu City with 77.6%. 21.2% agree that it is a challenge while 1.2% neither agree nor disagree.

4.3.2 High interest rate

Table 4.6

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	40	47.1	47.6	47.6
	Agree	30	35.3	35.7	83.3
	Neither agree nor	2	2.4	2.4	85.7

	disagree				
	Disagree	11	12.9	13.1	98.8
	Strongly Disagree	1	1.2	1.2	100.0
	Total	84	98.8	100.0	
Missing	System	1	1.2		
Total		85	100.0		

47.6% strongly agree that high interest rates are of the financial challenges affecting small and medium enterprises in Kisumu City, 35.7 agree, 2.4% neither agree nor disagree, 13.1% disagree and 1.2% strongly disagree.

4.3.3 New laws and regulations

Table 4.7

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	37	43.5	46.8	46.8
	Agree	24	28.2	30.4	77.2
	Neither agree nor disagree	3	3.5	3.8	81.0
	Disagree	10	11.8	12.7	93.7
	Strongly Disagree	5	5.9	6.3	100.0
	Total	79	92.9	100.0	
Missing	System	6	7.1		
Total		85	100.0		

Majority of the respondents 46.8% strongly agree that new laws and regulation is one of the financial challenge facing small and medium enterprises in Kisumu City, 30.4% agree, 3.8% neither agree nor disagree, 12.7% disagree and 6.3% strongly disagree.

4.4 Effects of financial challenges on growth

4.4.1 Lack of adequate finance and limited access to credit

Table 4.8

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	69	81.2	81.2	81.2
	Agree	15	17.6	17.6	98.8
	Neither agree nor disagree	1	1.2	1.2	100.0
	Total	85	100.0	100.0	

81.2% of the respondents strongly agree that lack of adequate finance and limited access to credit affects the growth of small and medium enterprises in Kisumu City while 17.6% agree. 1.2% neither agrees nor disagrees.

4.4.2 High Interest Rate

Table 4.9

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	36	42.4	43.4	43.4
	Agree	33	38.8	39.8	83.1
	Disagree	14	16.5	16.9	100.0
	Total	83	97.6	100.0	
Missing	System	2	2.4		
Total		85	100.0		

43.4% of the respondents strongly agree that high interest rate affects growth of small and medium enterprises in Kisumu city, 39.8% agree and 16.9% disagree.

4.4.3 New laws and regulations

Table 4.10

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	33	38.8	39.8	39.8
	Agree	29	34.1	34.9	74.7
	Neither agree nor disagree	4	4.7	4.8	79.5

	Disagree	12	14.1	14.5	94.0
	Strongly Disagree	5	5.9	6.0	100.0
	Total	83	97.6	100.0	
Missing	System	2	2.4		
Total		85	100.0		

39.8% of the respondent strongly agrees that new laws and regulation affects growth of small and medium enterprises in Kisumu City, 34.9 agree, 4.8% neither agree nor disagree, 14.5% disagree and the remaining 6% strongly disagree.

4.5 Effects of financial challenges on profitability

4.5.1 Lack of adequate finances and limited access to credit

Table 4.11

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	53	62.4	62.4	62.4
	Agree	26	30.6	30.6	92.9
	Neither agree nor disagree	3	3.5	3.5	96.5
	Disagree	2	2.4	2.4	98.8
	Strongly Disagree	1	1.2	1.2	100.0
	Total	85	100.0	100.0	

62.4% of the respondents strongly agree that lack of adequate finance and limited access to credit affects profitability of small and medium enterprises in Kisumu City. 30.6% agree, 3.5% neither agree nor disagree and 1.2% disagree.

4.5.2 High Interest rate

Table 4.12

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	37	43.5	47.4	47.4
	Agree	19	22.4	24.4	71.8
	Neither agree nor disagree	1	1.2	1.3	73.1
	Disagree	20	23.5	25.6	98.7
	Strongly Disagree	1	1.2	1.3	100.0
	Total	78	91.8	100.0	
Missing	System	7	8.2		
Total		85	100.0		

47.4% of the respondents strongly agree that high interest rates affects profitability of small and medium enterprises in Kisumu City, 24.4% agree, 1.3% neither agree nor disagree, 25.6% disagree and 1.3% strongly disagree.

4.5.3 New laws and regulations

Table 4.13

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	31	36.5	37.3	37.3
	Agree	30	35.3	36.1	73.5
	Neither agree nor disagree	2	2.4	2.4	75.9
	Disagree	17	20.0	20.5	96.4
	Strongly Disagree	3	3.5	3.6	100.0
	Total	83	97.6	100.0	
Missing	System	2	2.4		
Total		85	100.0		

Majority of the respondents 37.3% strongly agree that new laws and regulation affects profitability of small and medium enterprises, 36.1% agree, 2.4% neither agree nor disagree, 20.5% disagree and 3.6% strongly disagree.

4.6 Effects of financial challenges on Innovation

4.6.1 Lack of adequate finance and limited access to credit

Table 4.14

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	59	69.4	72.8	72.8

	Agree	20	23.5	24.7	97.5
	Neither agree nor disagree	1	1.2	1.2	98.8
	Disagree	1	1.2	1.2	100.0
	Total	81	95.3	100.0	
Missing	System	4	4.7		
Total		85	100.0		

72.8% of the respondents strongly agree that lack of finance and limited access to credit affects financial innovation for small and medium enterprises in Kisumu City, 24.7% agree, 1.2% neither agree nor disagree and 1.2% disagree.

4.6.2 High Interest rate

Table 4.15

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	28	32.9	37.3	37.3
	Agree	35	41.2	46.7	84.0
	Neither agree nor disagree	1	1.2	1.3	85.3
	Disagree	11	12.9	14.7	100.0
	Total	75	88.2	100.0	
Missing	System	10	11.8		
Total		85	100.0		

37.3% of the respondents strongly agree that high interest rates affects financial innovation of small and medium enterprises in Kisumu City, 46.7% agree, 1.3% neither agrees nor disagree, and 14.7% disagree.

4.6.3 New laws and regulation

Table 4.16

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Agree	30	35.3	39.0	39.0
	Agree	27	31.8	35.1	74.0
	Neither agree nor disagree	3	3.5	3.9	77.9
	Disagree	13	15.3	16.9	94.8
	Strongly Disagree	4	4.7	5.2	100.0
	Total	77	90.6	100.0	
Missing	System	8	9.4		
Total		85	100.0		

39.0% of the respondents strongly agree that new laws and regulation affects financial innovation of small and medium enterprises, 35.1% agree, 3.9% neither agree nor disagree, 16.9% disagree and finally 5.2% strongly disagree.

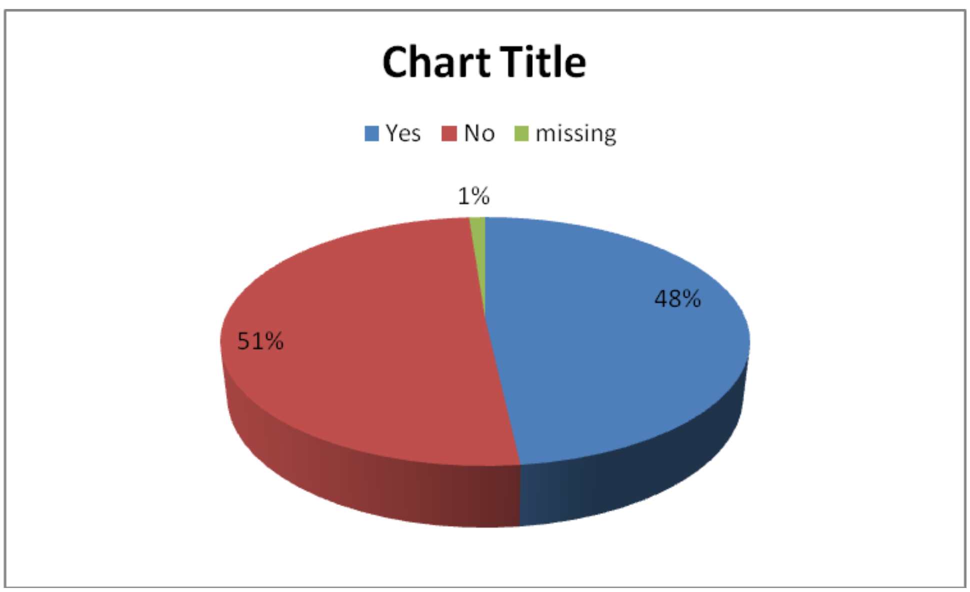
4.7 Negotiation of interest rates

Table 4.17

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	41	48.2	48.8	48.8
	No	43	50.6	51.2	100.0
	Total	84	98.8	100.0	
Missing	System	1	1.2		
Total		85	100.0		

48.8% of respondents agree that they negotiate interest rates with the lenders of funds While 51.2% disagree that they don't negotiate interest rate with the lenders.

Figure 4.4



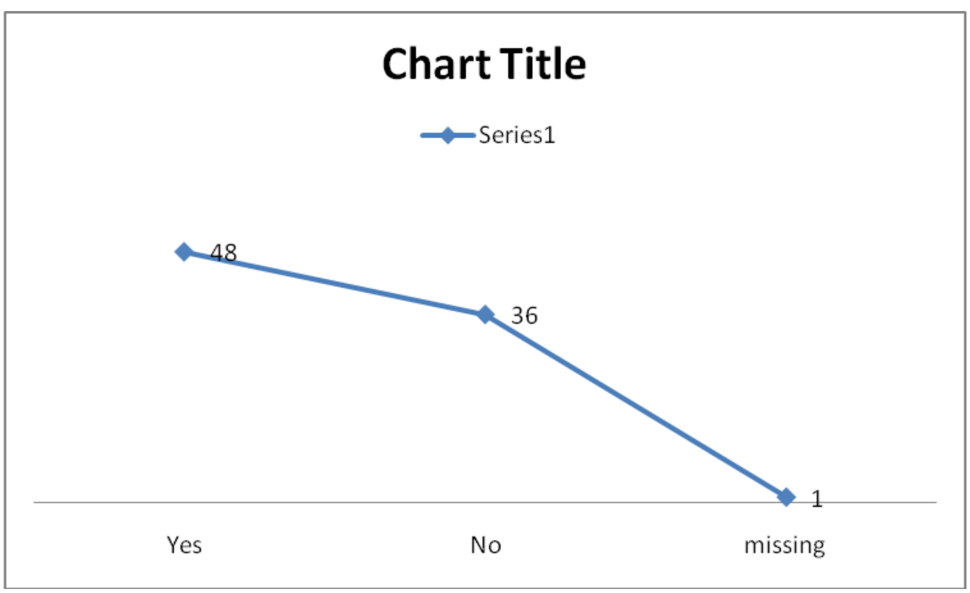
4.8 Use of technology to access services rendered by financial institution

Table 4.18

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	48	56.5	57.1	57.1
	No	36	42.4	42.9	100.0
	Total	84	98.8	100.0	
Missing	System	1	1.2		
Total		85	100.0		

57.1% of the respondents indicated that they use technology to access services rendered by financial institution while 42.9% do not use technology to access services rendered by financial institution.

Figure 4.5



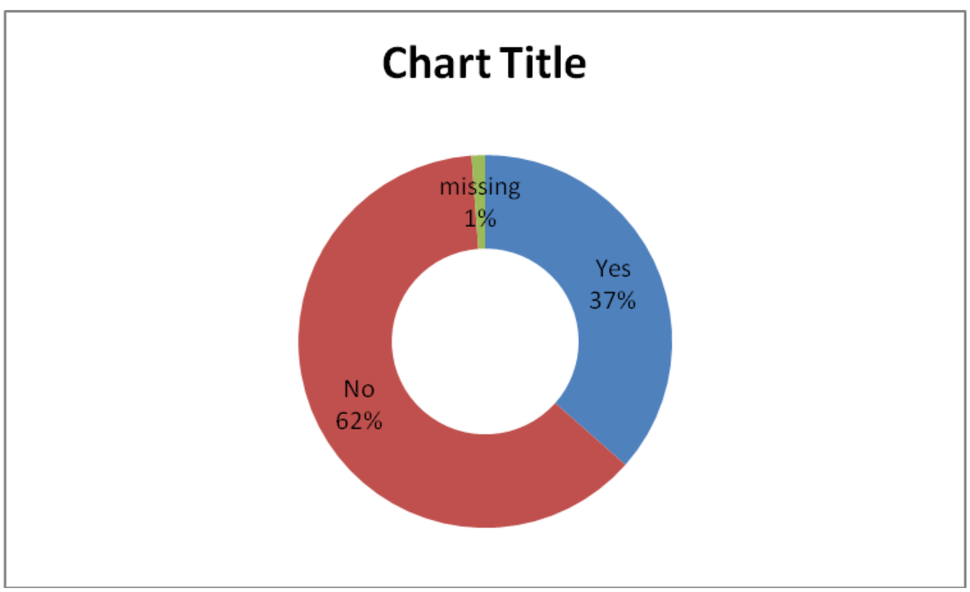
4.9 Full amounts of loan applied for

Table 4.19

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	31	36.5	36.9	36.9
	No	53	62.4	63.1	100.0
	Total	84	98.8	100.0	
Missing	System	1	1.2		
Total		85	100.0		

36.9% of the respondents agree that they receive full amount of loan applied for while 63.1% of the respondents indicate they do receive full amount of loan applied for as indicated in the above table.

Figure 4.6



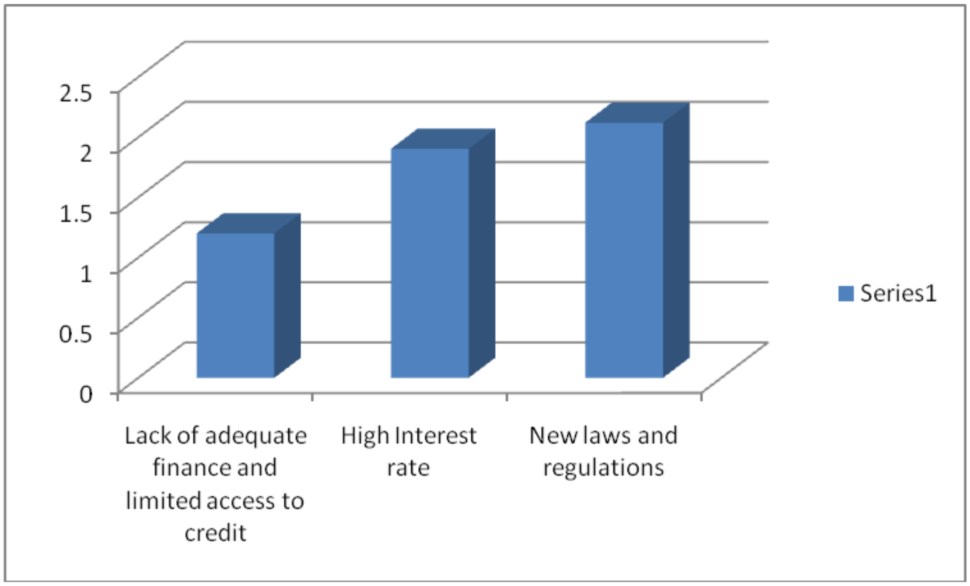
4.10 Descriptive Statistics on growth

Table 4.20

	N	Minimum	Maximum	Mean	Std. Deviation
Lack of adequate finance and limited access to credit	85	1.00	3.00	1.2000	.43095
High Interest rate	83	1.00	4.00	1.9036	1.05477
New laws and regulations	83	1.00	5.00	2.1205	1.25326
Valid N (list wise)	83				

From the descriptive table above, lack of adequate finance and limited access to credit has a mean variance of 1.2, high interest rate has 1.9036 and new laws and regulation has 2.1205.

Figure 4.7



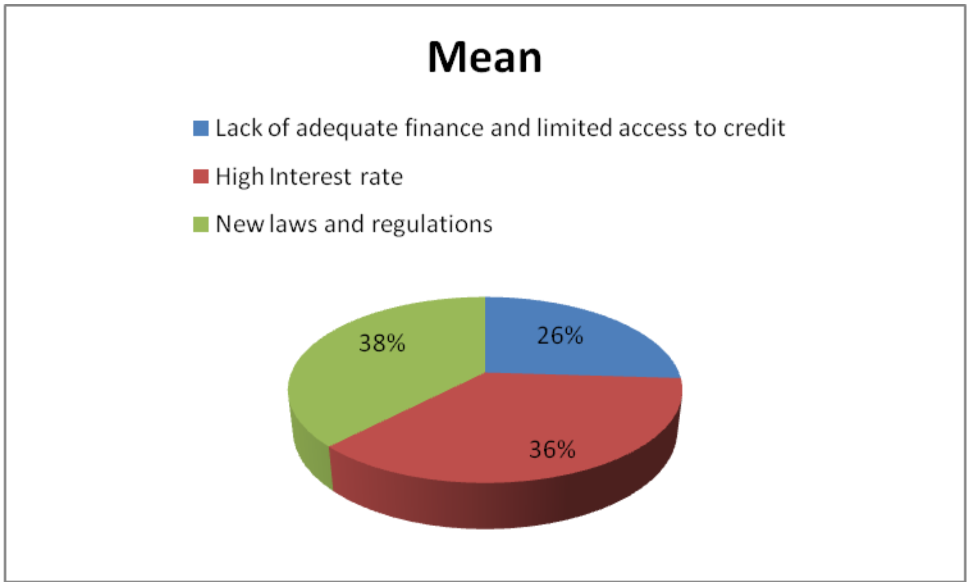
4.11 Descriptive Statistics on profitability

Table 4.21

	N	Minimum	Maximum	Mean	Std. Deviation
Lack of adequate finance and limited access to credit	85	1.00	5.00	1.4941	.78108
High Interest rate	78	1.00	5.00	2.0897	1.28109
New laws and regulations	83	1.00	5.00	2.1687	1.23781
Valid N (list wise)	77				

From the table above, lack of finance and limited access to credit has a mean variance of 1.4941, high interest rate has 2.0897 and new laws and regulation has 2.1687.

Figure 4.8



4.12 Descriptive Statistics on innovation

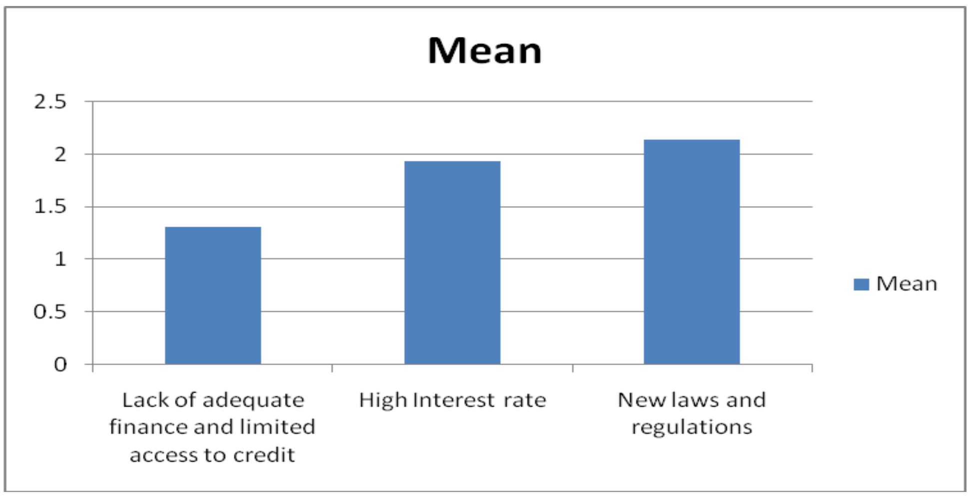
Table 4.22

	N	Minimum	Maximum	Mean	Std. Deviation
Lack of adequate finance and limited access to credit	81	1.00	4.00	1.3086	.56218
High Interest rate	75	1.00	4.00	1.9333	.99095

New laws and regulations	77	1.00	5.00	2.1429	1.25357
Valid N (list wise)	73				

Lack of finance and limited access to credit has a mean variance of 1.3086 while high interest rate has 1.9333. New laws and regulation has 2.1429.

Figure 4.9



4.13 Discussion

The study looks at the financial challenges facing small and medium enterprises in Kisumu City, Kenya and their financial performance implication. It has been observed from the analysis that majority of respondents operating in kisumu city operates auto spares and general shops as the nature of their business with a percentage point of 16.5 each, second hand cloth dealers and electronics shops follows with 10.6% each, food kiosks 5.9%, grocery and cosmetics 4.7%, salon and mechanics 3.5% each, M – pesa, cyber café, music store, fish monger, water vender, butchery and chemist are 2.04% each. Book shop, bars and accommodation, construction, farming, shoe dealer and laundry are 1.02% each. These show that majority of small and medium enterprises in Kisumu City are general shops, second hand cloth dealer and electronics shop.

65% of the respondents indicated that they are of a male gender while the remaining 35% were of female gender. In this regard most male operates SMEs in Kisumu City than their female counter parts. 58.5% of the respondent indicated that they fall within age bracket of between 20 – 40 years, 34.1% falls between 40 – 60 years and the remaining 7.3% were above 60 years. From the data, majority of small scale entrepreneurs are youths falling within age brackets of 20 to 40 years with middle age follows with age bracket between 40 to 60 years. Few elderly people operate SMEs in Kisumu City. Most of the respondents revealed that their highest level of education is secondary education which constitutes 49.4%, middle level colleges follow with 28.2%. Primary and university were 11.8% and 10.6% respectively.

The respondent also identified lack of adequate finance and limited access to credit as one of the financial challenges facing SMEs in Kisumu City with 77.6% strongly agree , 21.2% agree, 1.2% neither agree nor disagree. Other financial challenges identified are high interest rates with 47.6% strongly agree, 35.7%agree, 2.4% neither agree nor disagree, 13.1% disagree and 1.2% strongly disagree. 46.8% of the respondents strongly agree that new laws and regulation are one of the challenges facing them in their operation with 46.8% strongly agree, 30.4% agree,3.8% neither agree nor disagree, 12.7% disagree and 6.3% strongly disagree.

These financial challenges have implication in performance of small and medium enterprises. They impact on growth, profitability, and innovations of SMEs, with 81.2% of the respondents strongly agree that lack of adequate finance and limited access to credit has implication on growth, 17.6% agree and 1.2% neither agrees nor disagrees. 43.4% of the respondents strongly agree that interest rates has implication on growth with 39.8% agree and 16.9% disagree. 39.8% of the respondents strongly agree that new laws and regulation affects growth of SMEs with 34.9% agree, 4.8% neither agree nor disagree, 14.5% disagree and 6% disagree.

62.4% strongly agree that lack of adequate finance and limited access to credit has implication on profitability with 30.6% agree, 3.5% neither agree nor disagree, 2.4%

disagree and 1.2% strongly disagree. 47.4% of the respondents strongly agree that high interest rates affects profitability with 24.4% agree, 1.3% neither agree nor disagree, 25.6% disagree and 1.3% strongly disagree. 37.3% strongly agree that new laws and regulation has an implication on profitability with 36.1% agree, 2.4% neither agree nor disagree, 20.5% disagree and 3.6% strongly disagree. On financial innovation, 72.8% of the respondents strongly agree that lack of adequate finance and limited access to credit affects financial innovation of SMEs, with 24.7% agree, 1.2% neither agree nor disagree,1.2% disagree. 37.3% of the respondents strongly agree that high interest rates affects financial innovation of SMEs, with 46.7% agree, 1.3% neither agree nor disagree and 14.7% disagree. On new laws and regulation, 39.0% strongly agree that it has implication on innovation with 35.1% agree, 3.9% neither agree nor disagree, 16.9% disagree and 5.2% strongly disagree.

On negotiation of interest rates, 51.2% do not negotiate interest rates with financial institution while 48.8% negotiate. 57.1% of the respondents indicated that they use technology to access services rendered by financial institution while 42.9% do not use technology to access services rendered by financial institution. 36.9% of the respondents receive full amount of loan applied for while the remaining 63.1% do not receive full amount of loan applied for from the lenders.

Observation by descriptive statistics indicates that lack of adequate finance and limited access to credit has a lot of impact on growth with a mean variance of 1.2 followed by high interest rates with 1.9036 and lastly new laws and regulation with mean variance of 2.1205. On profitability, lack of adequate finance and limited access to credit has a lot of impact on profitability with a mean variance of 1.49, followed by high interest rates with 2.09 and new laws and regulation with 2.17 mean variance. Innovation, lack of adequate finance and limited access to credit has a mean variance of 1.31, high interest rates 1.93 and finally new laws and regulation has mean variance of 2.14.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter highlight summary of key findings in chapter four and conclusions drawn based on the findings and recommendation thereof. The objective of the study was to establish financial challenges facing small and medium enterprises in Kisumu City, Kenya and their implication on financial performance.

5.2 Summary

In summary, the objective of the study was to establish financial challenges facing SMEs in Kisumu City, Kenya and their financial performance implication. The study was carried out in Kisumu city where 100 SMEs were sampled and 85 responses were received from the respondents.

The study reveals that major financial challenges facing small and medium enterprises are lack of adequate finance and limited access to credit, high interest rates and new laws and regulation. These financial challenges have a lot of implications on financial performance of small and medium enterprises. The financial challenges have implication on growth, profitability and financial innovation. Most of the respondents also indicated that they are not in a position to negotiate interest rates with financial institution. Majority also do not receive full amount of loan applied for confirming the credit rationing among SMES sector.

5.3 Conclusions

Based on the findings above, it is evident that there are financial challenges affecting SMEs in their operation, these are lack of finance and limited access to credit, high interest rates, and new laws and regulations. These financial challenges have implications on growth, profitability and financial innovations.

It is also observed that SMES do not have capacity to negotiate interest rates with the lenders and most surprisingly they do not receive full amount of loan applied for. The study reveals that inadequate finance and limited access to credit is the major challenge facing SMEs and this is in agreement with other empirical studies and theory of finance. High interest rate and new laws and regulations follow respectively.

5.4 Limitation of the study

There were a lot of challenges faced while carrying out this study. Out of 100 questionnaires issued to respondents, only 85 were received back from the respondents while the rest of respondents were not able to fill in questionnaire because of busy schedules. Out of 85 received, some respondents did not attempt some of the questions. Some were very cautious while receiving and responding to questions and this may have compromised the quality of the answer received.

Concentration of similar business in same geographic area was also a challenge. Most garage and auto spares are concentrated in jua kali, while Nyalenda, Manyatta, and Kendele have a lot of provisional stores. Concentration of similar businesses in same region has some influence in the result obtained.

5.5 Recommendations

Since lack of adequate finance and limited access to credit, high interest rates and new laws and regulations are the major financial challenges that have implication on growth, profitability and financial innovation, the National and County Government should develop a clear policy framework to address these challenges to mitigate severity in terms of growth, profitability and financial innovation. The policy infrastructure should address increase accessibility of fund by SMEs, provision of interest rates caps specifically for SMEs and formulation of favorable policies that may allow SMEs to securitize their shares in security exchanges.

For the purpose of intellectual and knowledge, other researchers should look into area of lease financing and SMEs. This area may provide a fertile ground to understand the implication of lease financing on SMEs performance.

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APPENDIX I

(QUESTIONNAIRE)

NB: Information provided in this questionnaire will be treated with utmost confidentially.

1. Name (Optional) ____________________________________
2. Nature of Business ____________________________________
3. Gender Male ☐ Female ☐
4. Age; Below 1 - 19 yrs ☐ 20 – 40 yrs ☐

   30 – 40 yrs ☐ 40 – 60 yrs ☐

   Above 60 yrs ☐

5. Highest level of education

   Primary ☐ Secondary ☐

   Middle level College ☐ University ☐

Part B

6. To what extend do you agree that the following are financial challenges that affects small and medium enterprises in Kisumu City

   (Please tick where necessary)

Financial Challenges	**Strongly Agree**	**Agree**	**Neither agree nor disagree**	**Disagree**	**Strongly Disagree**
Lack of adequate finance and limited access to credit					
High Interest rate					
New laws and regulations					

7. To what extend do you agree that the following financial challenges affects business growth of small and medium enterprises in Kisumu City
(Please tick where necessary)

Financial challenges	**Strongly Agree**	**Agree**	**Neither agree nor disagree**	**Disagree**	**Strongly Disagree**
Lack of adequate finance and limited access to credit					
High Interest rate					
New Laws and Regulations					

8. To what extend do you agree that the following financial challenges affects the profitability of small and medium size enterprises in Kisumu City.
(Tick where necessary)

Financial challenges	**Strongly Agree**	**Agree**	**Neither agree nor disagree**	**Disagree**	**Strongly Disagree**
Lack of adequate finance and limited access to credit					
High Interest rate					
New Laws and Regulations					

9. To what extend do you agree that the following financial challenges affects financial innovation of small and medium enterprises in Kisumu City?

Financial challenges	**Strongly Agree**	**Agree**	**Neither agree nor disagree**	**Disagree**	**Strongly Disagree**

Lack of adequate finance and limited access to credit					
High Interest rate					
New Laws and Regulations					

10. Do you negotiate interest rate with your lenders

Yes ☐ No ☐

11. Do you use technology to access services rendered by the financial institution

Yes ☐ No ☐

12. Do you receive full amounts of loan applied for

Yes ☐ No ☐