

**CHALLENGES FACED BY SMALL & MEDIUM ENTERPRISES IN ACCESSING
FINANCE IN KIAMBU TOWN, KENYA**

BY

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DECLARATION

This project is my original work and has never been presented for a degree in any other university.

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This project has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

To my parents Mr. and Mrs. Erastus M Kahora for their encouragement, selfless support and sacrifices on my behalf as well as ceaseless prayers.

To my Wife, Esther W Mburu for her love and patience and to my Son, Adrian Makena for endless stories during the course of the project

To my brothers and sister for what they have done to see me through this challenging education path.

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My greatest gratitude is to God the Almighty. He is a faithful God and may His name be praised for ever more.

ABSTRACT

Importance in the role of the SME in the development process continues to be in the forefront of policy debates not only in developing countries but also in developed countries. The advantages claimed for SME are various, including the encouragement of entrepreneurship; the greater likelihood that SME will utilize labor intensive technologies and thus have an immediate impact on employment generations; they can usually be established rapidly and put into operation to produce quick returns; and they may well become a countervailing force against economic power of large enterprises. More generally the development of SME is seen as accelerating the achievement of wider socio-economic objectives, including poverty alleviation.

In spite of the generally fast pace by which access to financial services for SME is being developed, significant segments of the SME sector do not yet benefit from the expansion and deepening of outreach. In attempting to gain access to financial services SME continue to face constraints caused by many factors. Thus this research intended to study the challenges faced by SME in access to finance. The findings indicated that problems faced by SMEs were insufficient collateral (71.4%) and Business proposal not acceptable (21.4%). On the same note the study identified that the most challenging stage of the loan process were; application and appraisal stage, loan approval stage and the period it took to process the loan. In terms of coping mechanism used to manage challenges faced by SMEs in accessing finance, the study identified the following; saving and trying to reduce expenses, attending financial seminars, use of merry go rounds, borrowing from friends at zero interest rates, reducing credit period for the firm's creditors, obtaining credit facilities from suppliers, ploughing back profits, offering stock as security, consulting with other SMEs owners, joining Sacco, using credit cards and overdrafts.

Based on the study findings, it is recommended that the stakeholders within the sector should endeavour to provide financial information infrastructure, the government and financial institutions should also provide a good economic environment where SMEs can be able to borrow at reasonable rates as well as friendly terms. It's also important to train most of the entrepreneurs on simple financial management tips, to enable them make informed financial decision.

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ABBREVIATIONS

AIM	Alternative Investment Market
GBP	Great Britain Pound
GDP	Gross Domestic Product
IFC	International Finance Corporation
KRA	Kenya Revenue Authority
OECD	Organisation for Economic Corporation Development
PECC	Pacific Economic Corporation Council
PIN	Personal Identification Number
SACCO	Saving & Credit Co-operatives
SMEs	Small & Medium Enterprises
SPSS	Statistical Package for Social Science
USAID	United State Agency for International Development
VAT	Value Added Tax

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

In recent years, there has been considerable and growing interest in entrepreneurship. According to Alvarez (1996:192) entrepreneurship fervor in the 1980s became a worldwide movement, spreading across countries regardless of level of development or even of their basic mentality or value orientation towards business activities. Despite its apparent importance, there is no agreed definition of either what constitutes an entrepreneurship. Indeed, according to Chell et al. (1991) the problem of identification of an entrepreneur has been confounded by the fact that there is still no standard, universally accepted definition of entrepreneurship. Often the term entrepreneurship is equated with new venture creation and small business management (Gibb, 1996) as well as the concepts of owner-management and self – employment.

In the literature, there are many supporting financing of entrepreneurs. Conceptually supporters are mostly based on the following core arguments (World Bank, 2004). First, advocates argue that entrepreneurship enhance competition and therefore have external benefits on economy-wide efficiency, innovation, and aggregate productivity growth. From this perspective, financing of entrepreneurs will help countries to exploit the social benefits from greater competition. Other proponents of entrepreneurship financing frequently claim that entrepreneurs are more productive than large firms with financial and institutional improvements, broadening access to financial services to entrepreneurs can boost economic growth and development. Finally, some argue entrepreneurship growth and expansion boost employment more than large firms because more entrepreneurial firms are labour intensive. From this perspective, financing of

entrepreneurs and encouraging entrepreneurship may represent poverty alleviation tools in developing countries.

1.1.1 Access to Finance by Small & Medium Enterprises

Generating an entrepreneurial idea is one thing but accessing the necessary finance to translate such ideas into reality is another. Many novel entrepreneurial ideas have been known to die simply because their originators could not fund them, and banks cannot be convinced that they were worth investing in. To be able to fund a business idea, there are various ways of accessing finance such as internal and external finance. Internal finance is concerned with sourcing funds through personal saving, and those of friends and relatives. However, as the firm grows its financing requirements may go beyond personal savings. The next source is external finance. External funding is based on merit according to the evaluation of financial institutions. There are two notable variants of external finance: debt financing and equity financing. Debt financing involves the procurement of interest bearing instruments. They are secured by asset-based collateral and have term structures, that is, either short or long term. The equity component of external finance gives the financier the right of ownership in the business and such may not require collateral since the equity participants will be part of the management of the business (Oguijiuba, Ohuche, and Adenuga, 2004).

Small businesses lack access to capital and money markets. Investors are unwilling to invest in proprietorships, partnerships or unlisted companies. As risk perception about small businesses is high. So is the cost of capital, institution credit, when available, requires collateral which in turn makes owner of the business even more vulnerable to

foreclosure. Despite efforts by financial institutions and public sector bodies to close funding gaps, Small and Medium Enterprises (SMEs) continue to experience difficulty in obtaining capital. These funding gaps relate to firm size, risk, knowledge and flexibility. In addition, SME borrowing requirements are small and more collateral may be required than SMEs can pledge. Further, the financial institutions may lack expertise in understanding SMEs and also flexibility in terms and conditions of financing that are required by SMEs (PECC, 2003). Small firms have traditionally encountered problems when approaching providers of finance for funds to support fixed capital investment and to provide working capital for the firm's operations. The presence and nature of a "finance gap" for small firms has been debated for decades, ever since the Macmillian report (World Bank, 2004)

According to (Clarke, 2001) obtaining finance is a long journey, the success of which depends on the methodology applied during evaluation and awarding of credit by financier. This journey starts from the application for the facility and ends at the time the loan from credit process is fully paid. Like, any human journey, the credit acquisition process has got no smooth paths, there are impediments and detours before destination is reached. When in business you cannot avoid seeking for a loan when need arises, its important to know how banks can lend or refuse to lend a business funds. First and foremost, banks trade on customer deposits. They lend at interest rates high enough to pay their operating overheads and leave balances to pay interest (lower) to the customers whose deposits are being loaned out.

When bank managers evaluate loan applications, they want to know whether by lending money can get his amount back and earn profit on it. Evaluate whether a business can repay the loan with interest for the period in question. They want to see this in banks statements or cash-flow statements. They want to see flow of money in and out of the business. Apart from the ability to repay loan as well as agreed interest, the manager wants to evaluate how risky a business is. The banks want to see from the balance sheet how much the owner has invested in the business including profits that have not been withdrawn. To the bank manager, it's important to know about the management of investment. Finally, he wants to see the collateral you are offering as security for the loan. It's also important to note that a bank does not lend with a view to selling collateral to recover their money. (Rukunga, 1999)

Many economist, most notably Stiglitz and Weiss (1981), contend that lending institutions may indeed fail to allocate loans efficiently because of fundamental information problems in the market for small business loans. These information problems may be so severe that they lead to credit rationing and constitute the failure of credit market. According to Caves (1998), the prevalence of credit market failure is an important constraint on growth of SMEs. Since the closure cost rate of SMEs is higher than larger enterprises, the financial service providers tend to consider SME financing risky. Small & Medium Enterprises financing also requires innovations in lending technology that could reduce risk to the lender in ways that does not increase the overall transaction cost to the entrepreneur.

Conventional wisdom argues that bank or commercial finance company lending would typically not be available to small businesses until they achieve a level of production where their balance sheet reflect substantial tangible business assets that might be pledged as collateral, such as accounts receivable, inventory, and equipment.(Brewer and Genay, 1994). This sequencing of funding over the growth cycle of a firm can be viewed in the context of modern information based theory of security design in notion of financial pecking order. Costly state verification (Townsend 1979, Diamond 1984) and adverse selection (Myers 1984, Myers and Maljluf 1984, Nachman and Noe 1994) arguments suggest the optimality of debt contracts after insider finance has been exhausted. These debt contracts could include trade credit, commercial bank loans and finance company loan.

1.1.2 Small & Medium Enterprises in Kiambu Town

According to the 2005-2010 District strategic plan, Kiambu Town is one of the townies in Kiambu County, Central Province. It covers an area of 1,323.9 sq Km² and had an urban population of population 13,814.Its the capital of Kiambu District and borders Nairobi City and Kajiado County to South, Nakuru County to the West and Muranga County to the East.

Following the construction of multilane Thika highway, recent development of Fourway Junction which comprises of residential property, offices, BPO park mall, a hotel and country club as well as much publicized Tatu City which is expected to house more than 62,000 residents who will have opportunity to live and work within their community

together with other factors like its proximity to Nairobi has led to the fast growth of many small business in the town, presence of established industrial centre in Ruiru and Thika plus a rich agricultural hinterland has attracted developments numerous commercial activities such as Jua Kali sheds, retail manufacturing, hotels and sale of industrial and agricultural commodities which has attracted the researcher to use Kiambu Town as a case study.

1.2 Research Problem

Lack of access to credit is almost universally indicated as key problem for Small and Medium Enterprises. In most cases, even where credit is available mainly through banks, the entrepreneur may lack freedom of choice because the bank's lending conditions may force the purchase of heavy, immovable equipments that can serve as collateral for the bank. Credit constrains operate in variety of ways in Kenya where undeveloped capital market forces entrepreneurs to rely on self-financing or borrowing from friends and relatives. Lack of access to long-term credit for micro, small and medium enterprise forces them to rely on high cost short term finance. (Wanjohi and Mugure, 2008).

According to World Bank (2004) Small & Medium Enterprises may need access to credit services in order to meet their business demands e.g. finance purchase of equipment, growth, improve infrastructure and working capital. Due uncertain environment, lack of proper legal framework, high illiteracy and perception towards borrowing, credit service providers find it hard and risky to finance most of the SMEs.

Kiambu town is surrounded by hilly Kikuyu farmland although is under urbanization as Nairobi is growing fast and more people settle in neighbouring towns. There are also many non kikuyu who settled during colonial era as farm workers in the major coffee estates with the proximity of Kiambu town, with the death of farming many have established business in the town which can be considered during this research. Ten years ago, Kiambu was agricultural zone with green lush vegetation of coffee and tea plantations, but the region has lately opened up for development with developers invading prime land to build homes for either sale or rent to an already bulging Nairobi population. Located 22 Kilometres from Nairobi, its population density is relatively increasing due to the influx of residents. The booming housing business is now threatening the area's economic activity, agriculture as many farmers are now selling off their land to developers with others cutting down their coffee and tea bushes to pave way for the now booming construction business and many have established small businesses as a way of livelihood.

The town is preferred for its location, proximity to the city centre and its attractive climate and landscape. Another factor has been its closeness to the United Nations offices in Nairobi and the leafy Suburbs Runda and Muthaiga suburbs. There is need, however, for land-use planning because the agricultural productivity of the land is being wasted. The real estate boom has benefited the town, with the major banks such as Equity bank, Cooperative Bank, Family Bank, Barclays, Standard Chartered and the Kenya Commercial Bank having their presence here. The presence of shopping malls, infrastructural development and employment opportunities are key indicators that even the commercial developments have gained ground in this town.

Kiambu is seen as a future anchor to the capital city Nairobi which is undergoing rapid development with limited space for growth. The town has recorded a high increase in population as well as business as entrepreneurs competing against each other to establish outlets that will serve the ever growing population. However, most of these entrepreneurs in Kiambu town are faced with different challenges like insecurity, lack of regulatory framework, harassment by County Council askaris, poor business networks, unfair competition and access finance among many others. (Kiambu District Strategic Plan 2005-2010)

According to Kiambu Municipal Council Kiambu markets were established primarily for the retailing fresh farm produce. Grocers, stocks different kinds of foods from assorted places and cultures, and sells them to customers. Kiambu markets are well known to supply fresh organic foods to its customers from within the municipality and other customers from neighbouring localities. Shopping at Kiambu markets is the easiest way to shop locally and this has even been improved by establishment of Nakummat Ridge Ways, the presence of these markets and supermarkets have attracted immigrants from other towns who have promoted entrepreneurship within the town.

The 1999 Baseline Survey concludes that the demand for SME credit is one of the least studied aspects of the sector. Much more needs to be done to understand the nature of the “missing middle” as well as challenges of accessing SME finance and the bridge between the micro-finance level and that of commercial bank financing. Although the micro/cooperative –finance level and relatively well-developed compared to the neighbouring countries, the provision of services is highly segmented and disjointed with most outlets concentrated in the Nairobi region. Considering how significant the

contributions of the SME sectors are to the economy (contributing an estimated 30.5per cent of the current GDP and 41 per cent of non – agricultural GDP), this segment of the economy has been largely starved of credit and other financial services. (World Bank 2004)

Locally prior study on access to finance by firms focused on different areas. Kamau, (2008) focused on the critical factors affecting accessibility of credit services by small scale tea farmers, Wanjohi & Mugure (2008) Factors affecting growth of MSEs in Rural Areas in Kenya while Wasonga, J.K (2008) did research on challenges in financing SMEs in Kenya. The experience of Fina Bank of Kenya Limited, however the project is unique in that it seeks to research on the specific challenges being faced by SMEs in accessing finance in one of the growing towns of Nairobi environs. Given the contribution of SMEs to the Kenyan economy, there is need to conduct an empirical study to examine not only the challenges they face in accessing finance but also the approaches that can be adopted to manage these challenges with reference to SMEs firm operating in Kiambu Town. This study will help to fill the void in the knowledge gap. Therefore, this study seeks to answer the following questions;

- i. What are the challenges facing SMEs operating in Kiambu town in accessing finance?
- ii. What are the best approaches that can be used by SMEs operating in Kiambu town in managing these challenges?

1.3 Objectives of the Study

The study objectives were;

- i. To determine challenges facing SMEs operating in Kiambu town in accessing finance.
- ii. Establishing the coping mechanism employed by SMEs operating in Kiambu town in managing these challenges.

1.4 Importance of the Study

The need to manage challenges faced by SMEs in access of finance has now become even more vital amid the increasing forces of globalization and liberalization of business across the world. Likewise, the financial institutions have to observe rigid rules following international standards and the latest economic meltdown that have left majority of the banks with huge non performing loan books in the developed world. The financiers will have valuable information and insight on to how they can plan, if at all they are willing to continue financing SMEs.

The study would be of great importance to other researchers and academicians who seek to understand the challenges faced by SMEs in accessing financing and how these challenges could be managed.

The study would highlight challenges faced by the SMEs in access of credit. Once the challenges and ways of managing them are identified, they would assist credit service providers with information that could be used to extend their services to these SMEs.

The study would assist SMEs by opening their eyes on the ways of managing the challenges they are faced with and also provide alternative sources of finance that would give them better chance of survival, growth and success in the global competitive corporate setting.

The government could use the this research paper to design and implement policies that are meant to enhance access to credit by SMEs and they contribute significantly to growth and development of the country.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The financing of small and medium – size enterprises has been a subject of great interest both policy makers and researchers because of significant of SMEs in private sector around the world. Data collected by Ayyari, Beck and Demircuc-Kent (2007) for 76 developed and developing countries indicate that, on average, SMEs account for close to 60% of manufacturing employment. More importantly, a number of studies using firm – level survey data have shown that SMEs not only perceive access to finance and the cost of credit to be greater obstacles than large firms (Oya P.A, Nataliya M & Valentine S 2011).

Recent studies show that SME development is closely linked with growth. For example, Beck *et al* (2005a) found a robust, positive relationship between the relative size of the SME sector and economic growth, even when controlling other growth determinants. According to Ayyagari *et al* (2007), in high – income countries formal SMEs contribute to 50 percent of GDP on average. Furthermore, in many economies the majority of jobs are provided by SMEs. In OECD countries, for example, SMEs with less than 250 employees employ two-thirds of formal work force (Beck et al., 2008). Using country-level data, Ayyari *et al.* (2005) estimate that, on average, SMEs account for close to 60 percent of employment in the manufacturing sector. According to SME Performance Review (EC,2009), between 2002 and 2008, the number of jobs in SMEs increased at an average annual rate of 1.9 percent while the number of jobs in large enterprises increased by only 0.8 percent. In absolute numbers, 9.4 million jobs were created in the SME sector

in EU-27 between 2002 and 2008. Also, it is often argued SMEs are more innovative than large firms. In developed countries, SMEs commonly follow “niche strategies” using high product quality, flexibility, and responsiveness to customer needs as a means of competing with large – scale mass produces(Hallberg, 2000).

As the world economics are recovering from the financial crisis of 2008-9, many economies urgently need to create employment opportunities for the citizens. In this respect, creation and growth of SMEs is an important item on the policy agenda due to evidence that points to significant contributions by SMEs to employment. In addition, regulatory measures are necessary to ease formal financial services by SMEs. Historically, SMEs have been more likely than larger firms to be denied new loans during financial crisis. For example, Hallberg (2000) argues that the events of the 1990s in Latin America and East Asia confirm this proposition. More recently, in the aftermath of the global financial crisis, SME Performance Review (EC, 2009) reports anecdotal evidence pointing to insufficient market demand as the prime obstacle faced by SMEs, followed by difficulties in accessing finance.

2.2 The Role of SMEs in the Economy

The development of small and medium sized enterprises has often been graded as a “missing link” in development strategies of African countries, as several import-substitution policies have favoured large corporations at the expense of SMEs (Parker et al 1995). Several arguments have been given for putting SMEs at the centre of development strategies. The main reason is on the simple observation that they constitute

the large portion of employment in developing countries especially the micro-enterprise segment.

Besides the relative weight of SMEs in total employment, other arguments given are usually related to SMEs labour-intensiveness. Some of the available empirical evidence shows, however, that labour intensity is more related to industry types rather than firm size (Snodgrass and Biggs 1996), which in developing countries (due to the particular industry mix) translates into SMEs being labour intensive than large corporations. Labour-intensity results into a lower capital cost being associated with higher employment generation. In addition, SMEs “labour – intensiveness” is also responsible for SMEs being closely linked to “labour force supply-driven” survival strategies (Liedholm, 2001) most common during recessions, natural disasters, conflict and post-conflict situations.

The other reason that justifies why policy-makers are giving special attention to SME sector is that SMEs are more able to succeed in smaller urban and in rural areas. This is mainly the result of SMEs having less need of capital and support infrastructure, when compared with larger firms. The regional reach of SMEs is critical factor especially for African countries where agriculture represents up to 46% of GDP and where it employs on average 72% of the economically active male population and 85% of the female population (World Bank, 2004). SMEs are therefore responsible for evenly income distribution and also play a very important role in stopping migration flows from rural areas to cities. SMEs are also seen to be more able to leverage on and expand local

capacities as opposed to larger companies, which usually import know-how from developed countries. Moreover, they are also often recognized as being a breeding place for entrepreneurs. Finally, SMEs are considered to be more flexible in adapting to client requirements, being known for their ability to adapt quickly to market trends, as most of the operating costs are variable.

It is, however, somewhat difficult to assess the weight of SMEs in the developing world's economies. This is not only due to lack of statistical data and research on industrial structures in developing countries, but due to problems associated with inclusion of the informal sector. However, SMEs are normally considered to employ a significant part of the working population in developing countries. Review of normal survey conducted in African countries estimates that between 17% and 27% of the working age population are employed in SMEs, being nearly twice the employment of large scale enterprises and public sector (Liedholm, 2001). USAID considers that SMEs often employ a third or more of the labour force in low income countries. In Uganda, a survey of SMEs commissioned by USAID in 1995 established that 22% of all households in the country engage in some sort of small business activities and that these activities employ around 29% of the country's labour force. In Kenya, for example, Mullei & Bokea (1999) indicate that the SMEs sector employed around 2.3M people and generate around 14% of the country's GDP.

2.3 Access to Finance by Small & Medium Enterprises

The provision of credit has increasingly been regarded as an important tool for raising the incomes of rural populations, mainly by mobilizing resources to more productive uses.

As development takes place, one question that arises is the extent to which credit can be offered to the rural poor facilities their taking advantage of the developing entrepreneurial activities. The generation of self – employment in non- farm activities requires investment in working capital. However, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans, by increasing family income, can help the poor to accumulate their own capital and invest in employment-generating activities. (Hossain, 1988)

Commercial banks and other formal institutions fail to cater for the credit needs of small businesses, however, mainly due to their lending terms and conditions. It is generally the rules and regulations of the formal financial institutions that have created the myth that poor are not bankable, and since they can't afford the required collateral, they are considered uncreditworthy (Adera, 1995). Hence despite efforts to overcome the widespread lack of financial services, especially among small businesses in developing countries, and the expansion of credit among small business of these countries, the majority still have only limited access to bank services to support their private initiatives (Braverman and Guasch, 1986)

Access to financial services by small business is normally seen as one of the constraints limiting their benefits from credit facilities, in most cases the access problem, especially among formal financial institutions, is one created by the institutions mainly through their lending policies. This is displayed in the form of the prescribed minimum loan amounts, complicated application procedure and restrictions on credit for specific purposes

(Schmidt and Kropp, 1987) further argue that the type of financial institution and policy will often determine the access problem. Where credit even duration, terms of payment, required security and the provision of supplementary services do not fit the needs of the target group, potential borrowers will not apply for credit even where it exists and when, they will be denied access.

The Grameen Bank experience shows that most of the conditions imposed by formal credit institutions like requirements should not actually stand in the way of small businesses and poor in obtaining credit. The poor can use the loans and repay if effective procedures of disbursement, supervision and repayment have been established. On the issue of interest rates, the bank also supports the view that high interest rate credit can help to keep away the influential non – target credit programme (Hossain, 1988). This further demonstrates the need to develop appropriate institutions for the delivery of loans to small business borrowers.

2.4 Obstacles faced by SMEs

Despite the importance of SMEs for job creation and production, most of the SME literature points to the fact these firms face higher barriers to external financing than large firms, which limit their growth and development (Beck *et al* 2008b). Numerous studies that use firm- level survey data demonstrate that access to finance and cost of credit do not only pose barriers to SME financing, but also constrain SMEs more than large firms. Small firms find it difficult to obtain commercial bank financing, especially long-term loans, for a number of reasons, including lack of collateral, difficulties in proving

creditworthiness, small cash flows, inadequate credit history, high risk premiums, underdeveloped bank- borrower relationships and high transaction costs (IFC, 2009) . This is evidenced in the works of Oya P.A, Nataliya M & Valentine S (2011) who concluded that smaller firms and firms in countries with underdeveloped financial and legal systems use less external finance, based on data from a firm-level survey in 48 countries.

There are various other financial challenges that face SMEs. They include the high cost of credit, high banking charges and fees. Financial constraints remain a major challenge facing Small and Medium Enterprises in Kenya (Wanjohi & Mugure, 2008). Lack of working capital is the important reason for business closure while lack of credit is second severest problem faced by SMEs (Kimunyu & Omiti, 2000)

According to Sara (2006) the research and surveys examining the financing of SMEs should be interpreted with caution for two reasons. First, there is no universal definition of ‘small’ business; the second is connected to the aggregation of the data. This is particularly important when examining how small businesses are financed because it is likely that the extent and source of funds will depend upon the size of business. For example, small firms with turnover of GBP 50,000 are likely to have very different capital structure from small firms with a turnover of GBP 1M. Another important factor that tends to affect the type of finance employed by a small enterprise is the industrial sector in which it operates. A firm which has tangible assets such as land and buildings that can be offered as security, such as a firm in the property sector, is likely to find it

easier to obtain funds than a firm in a sector whose assets are intangible in nature, such as a firm in the advertising industry whose main assets tend to be creative, reflecting the skills of the personnel they employ.

There is a very limited opportunity for small firms to raise funds in the equity markets. The main markets for small businesses in which to raise fund in the Alternative Investment Market (AIM), but only a very small proportion of small business in the developed and developing countries are eligible listing. In addition, there is some evidence to suggest that a large proportion of owner- managers of small firms are reluctant to seek equity finance from external sources (Cowling *et al.*, 1991; Binks *et al* 1990b). This reluctance is primarily due to the owner- manager's desire to maintain his independence and control of the business (Keasey and Watson, 1993).

According to Tucker and Lean (2003) one of the problems faced by small firms when attempting to raise finance is information asymmetry in that they cannot prove the quality of its investments projects to the provider of finance (usually banks) . Small firm managers often suffer from a lack of financial sophistication, as they are often product or service specialists, not specialists in the area of finance. Thus, the information asymmetry problem is partly one relating to difficulties in the spheres of communication and credibility. This is compounded by the fact that new or recent start-ups businesses may be unable to provide evidence of a good financial performance track record. Banks in particular rely on past financial performance as an indicator for the future profitability of projects.

According to Titman, Fan, and Twite (2003), a principal source of the financial constraints, influencing capital-structure, may be the existence of asymmetric information and the cost of contracting between companies and potential providers of external financing. Problems of financial constraints are potentially high in presence of poorly developed financial system. A well – developed financial system can facilitate the ability of a company to gain access to different sources of finance, providing cheaper finance to worthy companies (Guiso, Sapienza, and Zingales, 2004)

Owing to lack of business experience of many small owner-managers in the early years of the business, business risk may be more significant than large firms. Small firms generally have smaller financial reserves to draw on in times of crisis and are also relatively highly geared compared to larger firms due to the difficulty and expense of attracting new equity finance. Thus, such firms are characterized not only by higher business risk but also higher financial distress risk. Banks tend to respond to this risk by adopting a capital – gearing rather than an income- gearing approach to lending. Thus, rather than focusing their attention on evaluating the income streams flowing from an investment project, they may focus more on the value of collateral available in the event of financial distress. This creates a problem for small firms in that they often do not have significant fixed assets to secure on their early years of establishment. The stage of development, then, may be an important determinant of, and constrains on, the type and amount finance that a business can raise. Small firm financing, then, may be an important determinant of, and constraint on, the type and amount of finance raised. Small firms

financing then, will be heavily secured debt, with few incidences of external risk capital contribution (Cruickshank, 2000)

The attitude and objectives of the owner – manager can exert an important impact on the firm's ability to secure finance. Such managers are often unwilling to provide personal assets as collateral. Furthermore, many small businesses have objective other than growth as a priority (e.g. “lifestyle businesses”). However, Binks and Ennew (1996) argue that many small firms will be forced to provide yield expansion to protect their limited liability status (which would otherwise be eroded by the provision of personal assets as loan collateral). A primary motive for starting a small business is to exert greater control over the work environment and to internalize the benefits of personal effort and risk taking. In this regard, then, it is understandable that many small business managers would not countenance any dilution of this control through the introduction of outside equity from venture capitalists or business angels. Thus, the attitude of managers may sometimes contribute important constraints on the range of financing sources on the firm.

2.4.1 The Lending Infrastructure

The information infrastructure has a significant effect on the availability of credit to SMEs. One important aspect of the information infrastructure is the accounting environment. The key issues here are existence of strong account standards and credible independent accounting firms. These are necessary conditions for informative financial statements. These are also necessary conditions for the feasibility of many components of loan contracting. For example, financial covenants are not feasible if the financial ratios

calculated from banks financial statements are not reliable. Indices of global accounting standards, not surprisingly, indicate considerable variation across countries- not only between developed and developing economies but even among developed economies (La Porta, Lopez-de-Silanes, Shleifer, and Vishny 1998)

Another important aspect of the information infrastructure is the availability of information on payment performance. The extent, to which lenders share information about performance, have a significant effect on credit availability (Jappelli and Pagano 2001). Third party information exchanges or business credit bureaus provide a formal organization mechanism for the exchange of commercial payment performance information. Moreover, they have been shown to have power in predicting firm failure beyond financial ratios and other descriptive information about the firm (Kallberg and Udell 2003). Survey data also indicate that without credit bureaus the time to process loans, the cost of making loans, and the level of defaults would be higher (Miler 2003).

Empirical studies have shown that firms in countries with greater financial development and strong property rights have increased level of investments funded by external finance while firms in countries with weaker financial development and property rights are more likely to obtain less efficient financing from development banks, the government, or from informal sources. Smaller firms may particularly be affected. One study found that the effect of financial, legal and corruption problems consistently constrained the growth of smaller firms more than large firms a cross-country analysis. (Beck, Demirguc-Kunt, and Maksimovic 2004). A country commercial law, its bankruptcy laws, and the enforcement

respectively of these laws directly affect the ability of the banks to deploy specific contracting elements that can be used to mitigate the problem of information opacity. Specifically, they can affect the deployment of contracting elements that have been shown literature to minimize problems of adverse selection and moral hazard such as covenants, maturity, collateral and personal commitments (Berlin and Loeys 1988)

2.4.2 The Finance Gap

The finance gap refers to a situation where a firm has profitable opportunities but there are no, or sufficient, funds (either from internal or external sources) to exploit the opportunity. In finance theory this situation is known as hard capital rationing, as opposed to soft capital rationing which, to a great extent, is a self-imposed restriction. Hard capital rationing occurs when there is a mismatch between the supply and demand for finance from equity and debt sources (Wilson 1979).

Historically, the existence of a 'finance gap' was formally recognized nearly 70 years ago. In 1931 the Macmillan Committee reported that the financing needs of small business were not well served by the existing financial services institutions. The Committee reported that the financing needs of small business were not well served by the existing financial services institutions. The committee illustrated the importance given to the subject of financing small firms by government in the 1930s. Since then this criticism of financial institutions has been echoed by other important inquiries (Bolton, 1971). It has been argued that, if a finance gap still exists, it has been substantially narrowed because of these initiatives and subsequent responses by the market since the

1930s (Deakins, 1996). However, others dispute this claim on both empirical and theoretical grounds (Harrison and Mason, 1995).

It would appear that a subset of small businesses who wish to grow have more acute financing problems because of their need for development finance (Buckland and Davis, 1995). The Wilson Committee some 28 years ago, for example, recognized that the finance gap was a particular problem for such firms. However, the subset of small firms has attracted much attention (Buck and Davies, 1995) because of their significant actual or perceived contribution to the economy. A particular problem for growth firms is lack of access to equity capital. The problem is that businesses can only increase loan capital in proportion to assets held and the equity interest prevailing. Therefore, the only way the firm can increase capital is through injections of equity capital. The shortage of start-up and early stage equity capital in general, not necessarily in growth firms only, has also been cited as a particular problem for small enterprises (Robson Rhodes, 1984).

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter focused on overall methodology used in the study. It involved the methods the researcher used to collect the data for the study. These included research design, target population, sampling procedures, data collection and analysis procedures with the expected results as a representation of the study.

3.2 Research Design

The study was conducted by the use of the survey design. Survey studies are normally intended to describe and report the way things are. They are characterized by systematic collection of data from members of a given population through questionnaires and interviews. Thus this design was deemed appropriate in this study since it involved the procedures of collection and analysis of data from the 32 members of a sample, in this case SMEs whose businesses were located in Kiambu Town.

3.3 Population of the Study

This study used the SMEs definition based on employment size (and include both paid and unpaid workers) to determine which businesses would constitute the study population which consisted of 43 SMEs. According to Baseline Survey 1999 small enterprises employ less than 10 employees while medium enterprises employ 11-49 employees. The town has 43 SMEs that were counted by the researcher during a piloting phase testing, the same were confirmed with records at Kiambu Municipal Council, and these businesses formed a sample of the 32 SMEs for this research. Furthermore, to qualify as an SME for this study, a firm had to have been formally registered as Limited

Companies, Sole Proprietors or Partnerships, been operational for at least six months prior to conducting of the study, in the private sector, actively engaged in providing services or goods either to other business or directly to consumers.

The business owners and those involved in day to day running of the business were targeted since they were actually the main force behind the establishment and running of the respective SMEs and knew the kind of challenges in accessing credit. Those who run particular business on daily basis constituted the targeted population since they were entrusted with the responsibility of working towards the attainment of the firm's ultimate objective on behalf of the business owners. The numbers of employees was used to define the size of firms.

3.4 Sampling Procedures

The sample of 32 SMEs was selected from a representative number of 43 SMEs located in Kiambu Town and business owners and in their absence, the business managers. A stratified Simple random sampling procedure was used to arrive at the sample of SMEs. The SMEs operating in Kiambu Town were stratified according to their business size which would be determined by the employees in the business. For this particular research, there are two categories businesses; small- sized enterprises and medium-sized enterprises, according to Baseline Survey 1999, small enterprises are those with employing less than 10 employees while medium sized has 11-49 employees. These two categories or strata therefore formed the basis of the sample population. From each stratum, a representative number of businesses were randomly sampled.

A purposive sampling procedure was used to select the business owners or managers, this technique is generally used in quantitative studies and random selection of sample enables you to confidently generalize results from all size of sample. This group of respondents was expected to provide reliable information on the challenges facing businesses in accessing finance.

3.5 Data Collection

In this study, emphasis was given to primary data. The primary data was collected using questionnaire. This was semi- structured questionnaire (Appendix 1) which was primarily administered to the respondents personally to shorten the response time and enable on-the – spot clarification of any doubt that the respondents might have regarding any questions. This gave researcher opportunity to introduce the topic and motivate respondents to give their honest answer. However for respondents who had time constraints, questionnaire was dropped and picked later after self – administration.

Prior to data collection, an introduction letter authorizing data collection was obtained from the School of Business, University of Nairobi. Other relevant documents from the Kiambu Town Municipal were also obtained to facilitate process. The researcher sought audience with the Management of Kiambu Town Council with the objective of obtaining necessary documents important for reaching out to the individual business owners and managers, the researcher was able to reach out to the individual business owners and managers running businesses in Kiambu Town. Using the identified businesses and

managers, the researchers was able to reach them personally to explain the purpose of the study and sought their consent to participate.

3.6 Data Analysis

Anderson and Pole (2001), postulates that once data has been collected, the researcher must be able to interpret it reliably. The process involves summarizing and categorizing the data to a temporary manageable length, identify themes, analyze and assess. It is from this point that the researcher looked for meaning within the data and often related findings to previous studies to see if these support existing research.

Data for the study were analyzed using descriptive statistics, such as frequencies, percentages and measures of central tendency, with the application of the statistical package for social sciences (SPSS) software. Descriptive statistics was used to describe the basic features of the data in the study; they provided simple summaries about the sample and measures and the researcher used central tendency, mean, standard deviation which provided useful summary of security returns when performing analytical analysis and after analysis the data was then presented in tables, cross tabulation charts and graphs. Inferences were drawn from the results obtained.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS & DISCUSSION

4.1 Introduction

This chapter presents the results of the analysis of the data collected during the study. This chapter has been presented in three sections, that is, section one covered respondent's background information, section two dealt with key challenges faced by SMEs in accessing finance and section three covered information on coping mechanism used by SMEs.

4.2 Characteristics of Respondents

The characteristics of respondents are important in that they will help the researcher obtain basic information regarding the SMEs in Kiambu town; it will also give information on gender and marital status among men and women as it's also important in determining the gender dominance among SMEs in Kiambu Town. In addition to this it will also be a source of data on level of education, type of business, whether its sole proprietor, partnership or Limited company as well as the size of the organization based on the number of employees both full time and part time. These are SMEs who carries different types of trade and offer services in the town.

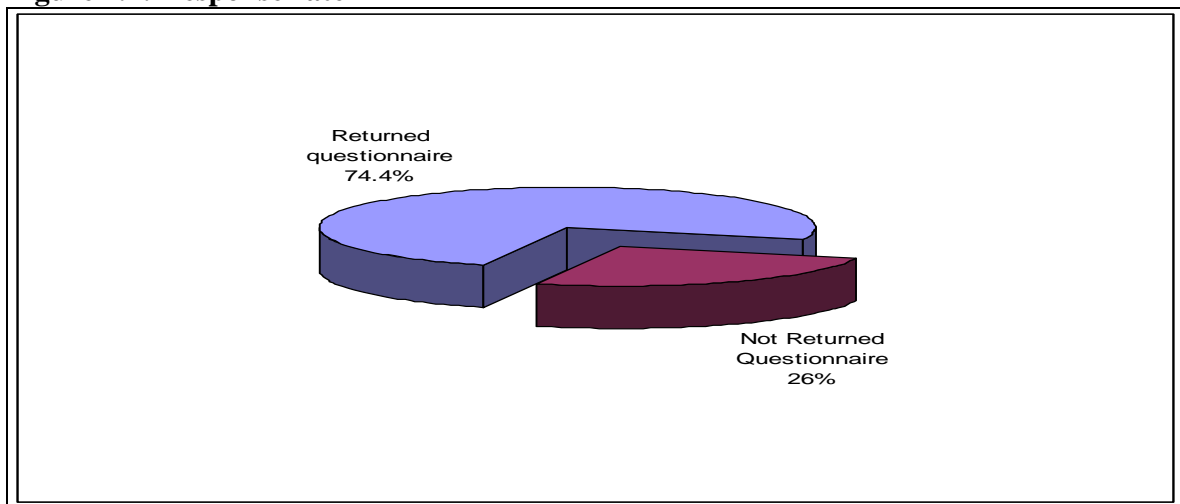
4.2.1 Response Rate

The response rate is important in that it shows the number of owners or managers who responded on the questionnaire that was given. It helps the researcher to determine if the number of respondents was enough to form an opinion. The higher the number of respondents the reliable the information obtained and the researcher received 32

questionnaires out of 40 which were administered and represents 80% response rate as shown in the figure 4.1 below.

From the data obtained it shows that 80% of the sample responded which is deemed as a true representation of the total population and would enable the researcher to draw conclusion. This high response was a result of the fact that the researcher gave questionnaire to the respondents which were picked later therefore giving enough time and also giving explanation to those who faced difficulties in answering the questions.

Figure 4.1: Response rate

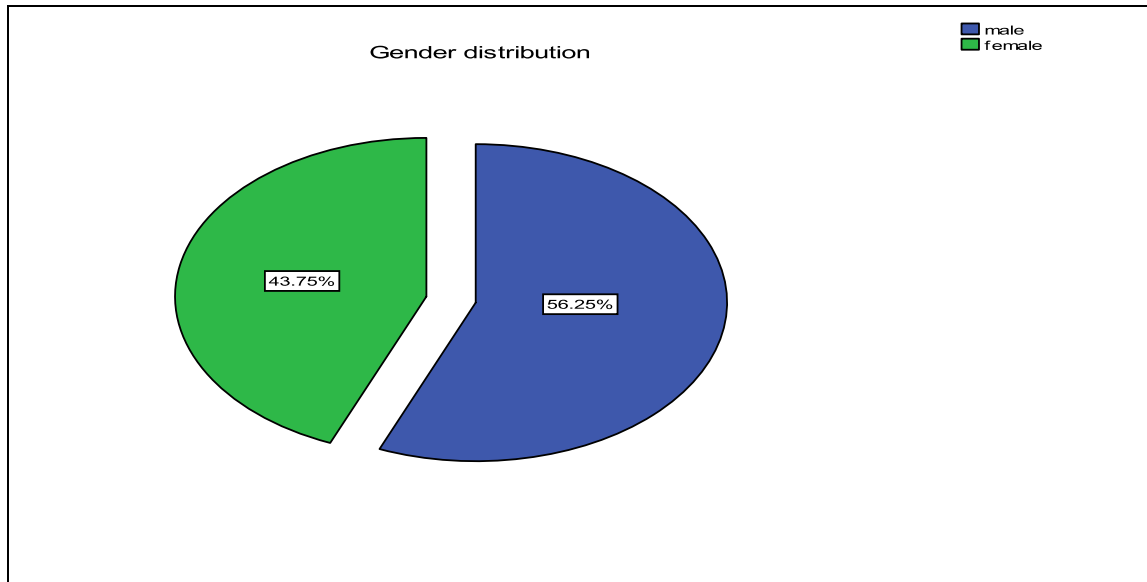


Source (Author 2011)

4.2.2: Gender of the respondents

The respondents were to indicate their gender, which would be used to show the distribution between men and women who own and operate SMEs in Kiambu Town. It's important to get the information on gender dominance among SMEs in the area as shown below;

Figure 4.2: Distribution by gender



Source (Author 2011)

The findings presented in figure 4.2 show that 56.25% of the respondents were male while 43.75% were female. Thus there was no significant gender disparity amongst the respondents and the indication are that SMEs are managed and run by both male and female at almost the same proportion, however there slightly more men than women which would be attributed to the fact that most men run business while the wife work elsewhere and also due to the fact that most of the business were inherited by men from the older generation, most probably from their parents. Another reason would be cultural belief that men are the owners of the property in the family set up and tend to succeed in business more than women.

4.2.3: Distribution by marital status

The respondents were required to indicate their marital status. The question was meant to give the status of business owner – managers who run SMEs in Kiambu town. It was

important to establish the marital status of most of business owners in this town. The results are as shown on the Table 4.1 below.

	Frequency	Percent	Cumulative Percent
Table 4.1: Marital status Single	12	37.5	37.5
Married	18	56.3	93.8
Divorced	1	3.1	96.9
Separated	1	3.1	100.0
Total	32	100.0	

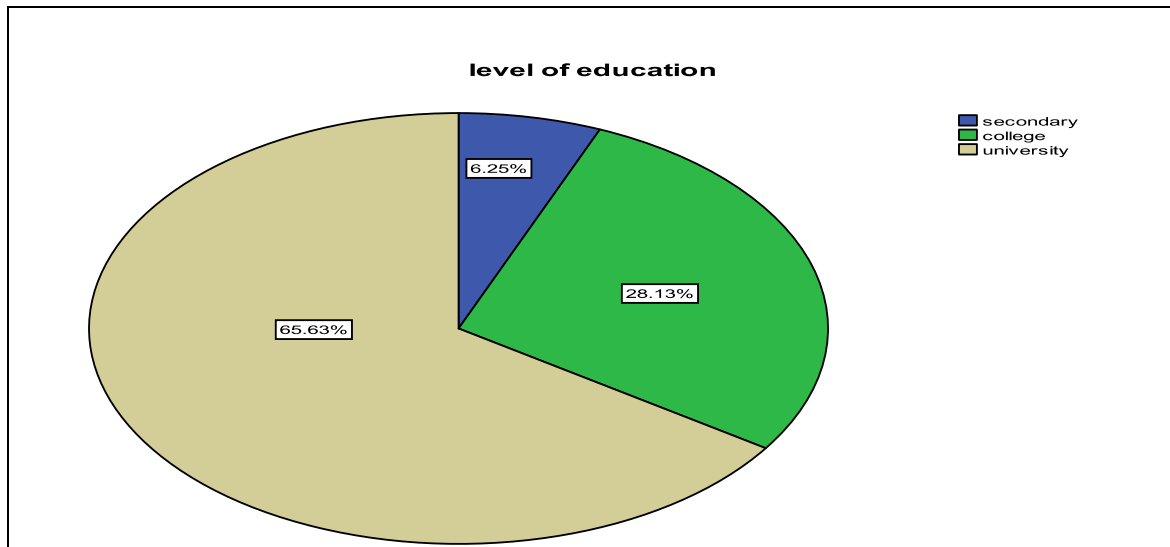
Source (Author 2011)

As indicated above, majority of the respondents were married (56.3%), followed by singles at 37.5% and divorced/separated at 3.1% respectively. This shows that majority of the respondents are married and this is attributed to the social status of most of the people since most successful SMEs have been in existence for sometime which means that most of the owners have attained the age of marriage.

4.2.4: Level of education

The respondents were required to indicate their level of education. The level of education is important in that it helped the researcher to determine the expertise and specialisation of most of the owners and business managers in this area. The response would also help the researcher determine how they understand the environment in which they operate and decision making process, the results obtained are shown on the figure 4.3

Figure 4.3: Distribution by level of education



Source (Author 2011)

The finding shows that majority (65.63%) of the respondents were university graduates, 28.12% had college education while 6.25% had secondary education. This confirms that the respondents have attained higher education which is encouraging since in theory most of the small business have been associated with the less educated but the research shows different results and this is could be attributed to the fact that most SMEs are seeking self employment and hunger of becoming their own bosses.

4.2.5: Type of business organization

The type of business is clearly defined based on its legal registration status in that there is sole proprietor where the owner operates and has registered the business as sole owner, partnership where they own business jointly may with a friend or spouse and limited company that have several owners each having a certain percentage of ownership. Its a well known fact that most of SMEs in this town have been passed through generations,

other than for few business owners who have relocated from other parts to set up business in the town especially after the improvement of infrastructure and drastic changes to cosmopolitan town. Data obtained on type of business is shown below on table 4.2

Table 4.2: Distribution by Type of business

	Frequency	Percent	Cumulative Percent
Sole proprietor	10	31.3	31.3
Partnership	5	15.6	46.9
Limited company	17	53.1	100.0
Total	32	100.0	

Source (Author 2011)

The firms under the study were registered as sole proprietor, partnership or limited company. More specific 53.1% of the respondents companies were limited companies, 31.3% operated as sole proprietors and the rest (15.6%) were partnerships. The results shows that the business are registered as limited company, this is mainly because limited companies have perpetual life, and makes it easy to raise additional capital from the directors/owners, the legal status of limited companies also enable get special consideration like tenders, credit facilities since there separation of ownership between the company and business. Succession also plays part in that most businesses owner incorporates their children to ensure continuity.

4.2.6: The number of employees employed

The question on number of employees including part time and full time was to enable the researcher establish if the business would be grouped as small or medium enterprise.

Small enterprises are those that employ less than 10 employees while medium enterprises employ 11-49 employees. In this town most businesses have less than 10 employees mainly because owners manage business with the support of their spouse and children. The family members are not paid any salary since they considered as the apparent heirs in case of any eventuality. However, with growth of businesses, the owners employ non family members but they ensure that the control and management remains with the family. The respondents were expected to indicate the number of employees who are paid salaries within their respective firms. The findings are as shown in table 4.3

Table 4.3: Distribution by number of employees

	Frequency	Percent	Cumulative Percent
Less than 10	15	46.9	46.9
10-50	4	12.5	59.4
50-100	13	40.6	100.0
Total	32	100.0	

Source (Author 2011)

As shown above, majority (46.9%) of the respondents firms employed less than 10 employees, 40.6% have 50 to 100 employees and 12.5% of them had 10 to 50 employees respectively. The results are reflection of how SMEs operate in the town, in that most of them are still at their infant stage where they need close management and most believe that outsiders would interfere with the smooth running of businesses.

4.2.7: Documents required by the law.

The study found out that most of the firms had legal documents required by the law for trading purposes. More so the available documents across the firms were; Kenya

Revenue Authority documents such as VAT registration certificate, PIN certificate, tax compliance certificate and annual tax returns. County Council documents available were; County Council single businesses permit. This question on documents helped to establish if the SMEs in Kiambu are legally compliant. The researcher intended to establish if the businesses have the minimum government requirements the government. The results show that these SMEs have the documents which ensure that they operate smoothly with no harassment by authorities for non compliance on the requirement.

4.3: Key challenges faced by SMEs in accessing finance

This section covers the questions posed to the respondents on the key challenges that they face in accessing finance. It's a well known fact that SMEs are faced with many challenges posed by both internal and external environment. In their response the SMEs cited the various challenges that they face in accessing finance from financial institution. Though most of the SMEs operate bank account and prefer to borrow from the bank, they cited difficulties like slow process of loan application, non financing of start ups, lack of collateral, adverse credit selection, financing less than amount applied for which inhibit them from meeting their financial requirement as well as institutional policies which makes the offer higher interest rates and credit rationing. This leaves significant numbers of potential borrowers without access to the much needed credit. Despite having many financial institutions that are financing SMEs in the country, these businesses still experience almost similar challenges based on the data from the respondents. The results on this section were presented in form of tables, frequencies pie charts and cross tabulations to give a clear picture of respondent's opinion.

4.3.1: Do you do and operate a bank account.

The question was imposed to establish if the SMEs operate accounts since this happens to be like a minimum requirement by financial institution in that has no bank account since most financial institution base their decision on creditworthiness on strength bank account. Despite the requirement on documentation, they mainly rely on the bank statement and audited account to make their decision on whether to finance or not and how much to finance. Almost all SMEs in this town have and operate accounts and this can be attributed to the recent the campaigns, promotions and personal selling being run by financial institutions e.g. KCB have a campaign dubbed as ‘weka weka upate ika’ where they are targeting the SMEs and encouraging them to open account and save in their effort to get cheap deposits and establish lasting relationship that would give additional transaction income.

Table 4.4: How long have you been operating the account?

	Frequency	Percent	Cumulative Percent
< 1 year	3	9.4	9.4
1-5 years	12	37.5	46.9
5-10 years	10	31.3	78.1
> 10 years	7	21.9	100.0
Total	32	100.0	

Source (Author 2011)

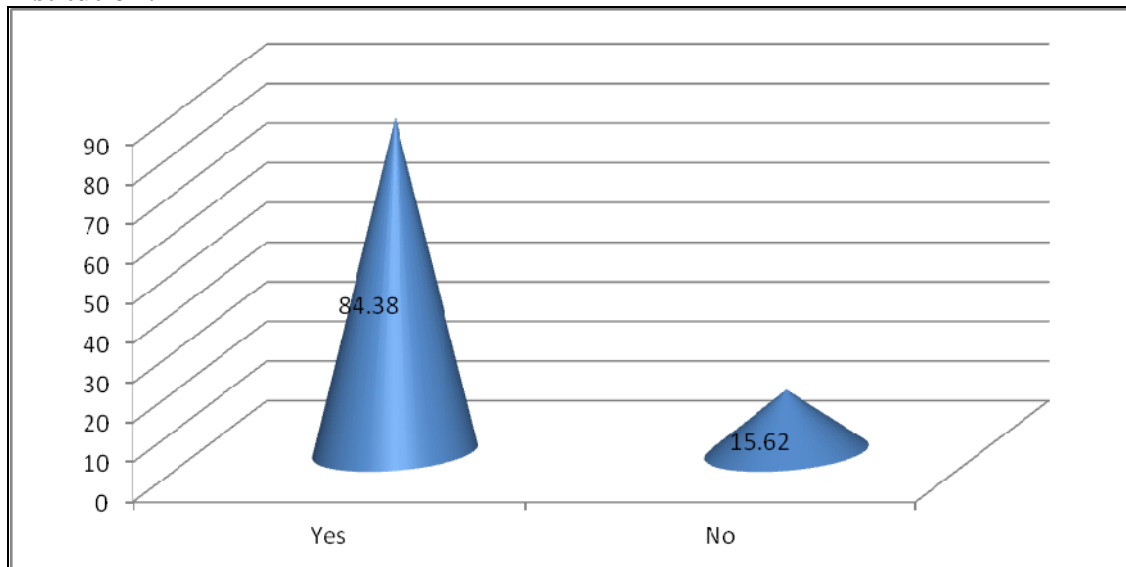
The respondents unanimously agreed that they hold and operate bank accounts in various banks. It was further notable that they have operated accounts for a period of time ranging from less than one year to over 10 years. More specific, 37.5% of the respondent

had operated their accounts for a period of 1 to 5 years, 31.3% for 5 to 10 years, 21.9% for over 10 years and only 9.4% for less than 1 year. The results shows that all SMEs operate account mainly due to insecurity associated with holding and transacting in cash as well as the fact that the banks have been enticed and enticing SMEs to open and operate account, after realizing that they form large part of the country's economy.

4.3.2: Sources of funds to finance business

The respondents were asked to state whether they have ever borrowed funds to finance their business from any financial institution. The question was intended to establish how most of the SMEs finance their operation and expansion as they outgrow the owner's capital and whether they consider bank as a way of sourcing funds. Though it well known that most of the SMEs have bank accounts the researcher wanted to establish if the SMEs borrow from the Banks since it gives indication on whether they obtained the loan applied for, or not and their opinion on the process. The results are as shown in figure 4.4 below

Figure 4.4: Have you borrowed funds to finance your business from any financial institution?



Source (Author 2011)

As shown in figure 4.4, most of the respondents (84.38%) indicated that they had borrowed funds from financial institutions to finance their business while as little as 15.62% had not borrowed funds from financial institutions. This shows that majority of SMEs relied on funds from financial institutions to finance their operations and hence has borrowed at one time to finance their operations. Most these SMEs had earlier indicated that they prefer borrowing from financial institutions despite the challenges they face.

4.3.3: Preferred sources of finance

The respondents were asked to rate their preferred sources of funds in a five point Likert scale. This question was meant to give comparisons on the most preferred source of finance considering that the SMEs have different sources where they can get financing. This would help the researcher to establish the most preferred sources of finance by most of the SMEs, they were given a range of between 1 to 5. The range was 'least preferred

(1) to 'most preferred' (5). The scores of 'least preferred' and 'preferred' have been taken to present a variable which had an impact to a small extent (S.E) (equivalent to mean score of 0 to 2.4 on the continuous Likert scale ;($0 \leq S.E < 2.4$). The score of both 'moderate preference' and 'most preferred' have been taken to represent a variable which had a large impact (L.E.) (equivalent to a mean score of 3.5 to 5.0 on a continuous Likert scale; $3.5 \leq L.E. < 5.0$). A standard deviation of > 1.25 implies a significant difference on the impact of the variable among respondents; this is arrived at on the assumption that the average score is 2.5 and half of the 2.5 is 1.25.

Table 4.5: Preferred sources of finance

	Mean	Std. Deviation
Bank	4.1562	1.19432
Micro financial institutions	3.5200	1.01982
Other sources (Chama)	2.8112	1.25147
Friends and relatives	1.3750	1.26364

Source (Author 2011)

The study found that respondents to a large extent; prefer to source for funds from banks (mean of 4.1562) and micro finance institutions (mean of 3.5200). On a moderate rate, the SMEs source finance from Chama's and only on rear occasions do they get funds from friends and relatives to finance their business operations. The results from the questionnaire shows that most of the SMEs prefer to source finance from Bank's despite the conditions imposed, this is because they are able rapport and confidence with the Bank's since they can be able to get finance in future once they establish strong

relationship. The other reason is because the SMEs trust banks more than other sources of finance due to their reliability.

4.3.4: Opinion on ease of accessing funds from financial institutions.

The respondents were to give opinion on ease of accessing finance based on their experience especially for those who have borrowed from financial institution. This gives the respondents a chance to give honest opinion on how they rate accessibility to finance in most of financial institution where they have ever applied for financing. The respondents were asked to rate how easy it has been for them to access funds from financial institutions. 46.9% of the respondents felt that it has been fairly easy to access funds, 3.1% rated access of funds from financial institutions to be very easy. On the other hand 33.4% felt that access of funds from financial institutions has been very difficult and 15.6% rated it as extremely difficult.

Table 4.6: Ease of accessing funds from financial institutions.

	Frequency	Percent	Cumulative Percent
Extremely difficult	5	15.6	15.6
Very difficult	11	34.4	50.0
Fairly easy	15	46.9	96.9
Very easy	1	3.1	100.0
Total	32	100.0	

Source (Author 2011)

From the data above, the results are that majority of the respondents feel that it's fairly easy to access finance from the banks. This is mainly because the banks are enticing

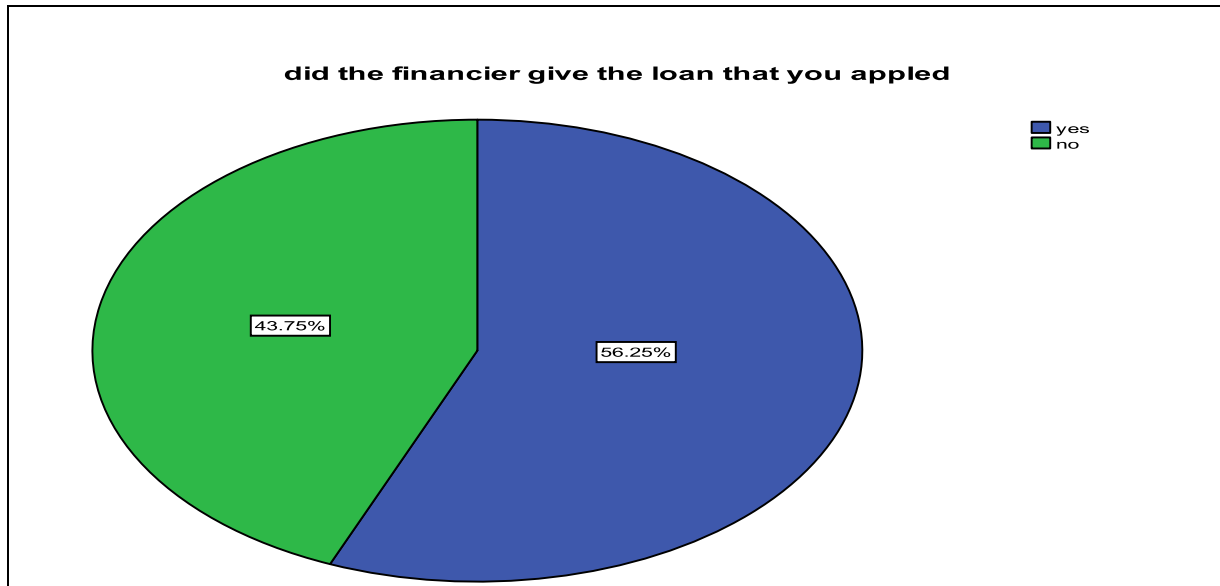
SMEs with loan as they compete to get them on board, cut throat competition from large MFI and non banking institutions have forced the bank to simplify the process. Funds from the Government that are channelled through the banks have also made access to funds easier.

4.3.5: Did the financier give the loan applied for

The researcher intended to investigate whether SMEs sought facility and got finance from financial institutions and if so, the amount of finance they obtained. This would help to determine if the respondent apply for financing from the bank and financed percentage they receive. Majority of the respondents have applied for a facility in banks which means that bank's are major source of finance for SMEs. However, the questionnaire sought to establish if the SMEs are financed the full amount applied for or partially financed mainly due to Bank's restrictions.

Based on this, the respondents were required to state whether the financier gave loans applied for, 56.25% of the respondents were given full amount while 43.75% were not given full amount applied for by the financier. According to the results obtained, it clearly shows that majority of the SMEs doesn't get the amount requested and are forced to look for other alternatives mainly due to the strict requirements imposed by financiers.

Figure 4.5: Did the financier give the loan applied for



Source (Author 2011)

4.3.6: Problems faced by SMEs who did not get full amount applied for

It was important to establish the problems that were faced by SMEs who were not financed the full amount. This is based on the fact that most financial institutions were not financing the SMEs the full amount applied for. It would help the researcher to be sure of the reasons that hindered financial institutions from giving funds as applied by the SMEs.

The data obtained was captured here below and the results from respondents indicated that insufficient collateral (71.4%) and Business proposal not acceptable (21.4%) were the main problems which hindered them from qualifying for full loan. Based on these results it, shows that majority of the respondents were not able to get the loan applied due to various reasons, this being 92.8% of the total respondents, leaving only 7.2%. This

clearly shows that SMEs are faced difficulties and are not able to get the amount of finance applied for.

Table 4.7: Did the financier give the loan that you applied * if no what were your problems Cross tabulation

Did the financier give the loan that you applied		If no what were your problems			Total
		Insufficient collateral	Business proposal not acceptable	Previous credit records	
No	Count	10	3	1	14
	%	71.4%	21.4%	7.1%	100.0%
Total	Count	10	3	1	14
	%	71.4%	21.4%	7.1%	100.0%

Source (Author 2011)

Table 4.8: Did the financier give the loan that you applied * if yes did the financier give full amount of loan Cross tabulation

Did the financier give the loan that you applied		if yes did the financier give full amount of loan		Total
		Yes	No	
Yes	Count	9	9	18
	%	50.0%	50.0%	100.0%
Total	Count	9	9	18
	%	50.0%	50.0%	100.0%

Source (Author 2011)

This question is a continuation of the previous one that sought to establish whether the SMEs are financed for the full amount that they have applied for. Though most of the SMEs seek financing from financial institutions, however according to the response majority of the SMEs were not able to get the loan applied for, the question further wanted to establish the reasons why they were unable to get the loan.

Of those who were given loans, 50% were awarded full loans applied for while 50% were not awarded full loans. Amongst the SMEs which were awarded partial loans, they gave reasons for partial awards as; lack of assets/collaterals, direct income ratio, lack of security, did not qualified for the amount applied for, lack of payment capability from my bank statement, it was first time borrowing so the financier awarded less than the amount applied for, other outstanding loans from other financiers and lack of audited books. The response shows that it's on rarely occasions that the respondents get the loan applied for due to different requirements such as collateral requirement, business proposal and previous credit history

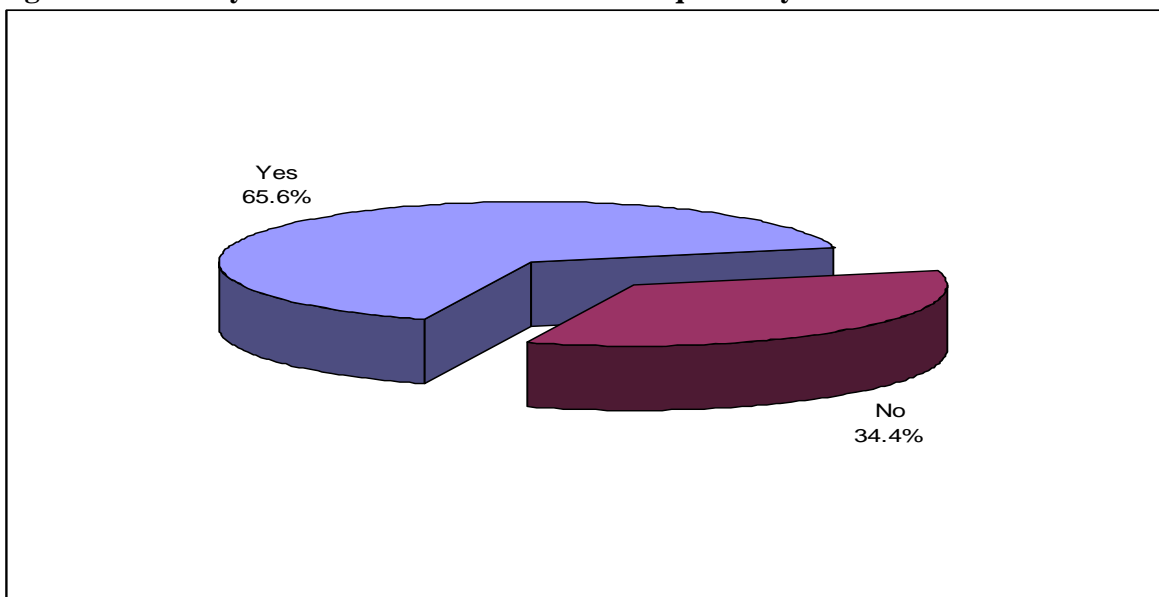
4.3.7: Capability of meeting all the conditions required by the bank

This was meant to establish if the respondents met all the conditions because loan facilities have its unique conditions that should be fulfilled before the loan is drawn. Though the conditions depend with the financier, some of them are almost similar depending with the applicant for the facility and in this case for SMEs. It would help to establish if SMEs face difficulties in their effort to fulfill bank's requirement.

The respondents were asked to state whether they were able to meet all the conditions required by the bank. As shown in figure 4.6 below, 65.63% of the respondents met all the conditions while 34.32% of the respondents did not meet all the conditions set by the

bank. The respondent further indicated that some of the difficult requirements for loan access were; closing other bank accounts to maintain only one account in the bank issuing the loan, documentation of relevant documents, book keeping, payment of commitment fees, getting guarantors from the same financial institution, accumulating contribution to secure a loan, keeping audited books, preparation of business plan to support the loan and availing financial statements for the last 5 years.

Figure 4.6: Were you able to meet all conditions required by the bank



Source (Author 2011)

4.3.8: Time taken to get the loan

This question was meant to establish if the time taken by financier to give loans to SMEs meet their expectation. It a known fact that most of the customers are unsatisfied with the time that Bank's take to have the loan drawdown and hence the question sought to know the opinion of SMEs based on the whole process from date when the respondent applies for the facility to when they receive the loan in their account. The purpose of the question was to establish if the timelines for the loans are acceptable by SMEs. Most of the delays

is occasioned by lack of understanding on part of SMEs and piecemeal submission documents and or conditions; this is attributed bank's lack of agreed credit appraisal process that is applied across the board. There also due to the changes in external environment that poses challenges to the operations of the financial institutions as well as trying to ensure that non performance loan is kept at minimum level as much as possible.

Table 4.8: How long did it take the bank to give the loan?

	Frequency	Percent	Cumulative Percent
< 1 week	4	12.5	12.5
1 month	11	34.4	46.9
3 months	10	31.3	78.1
> 3 months	7	21.9	100.0
Total	32	100.0	

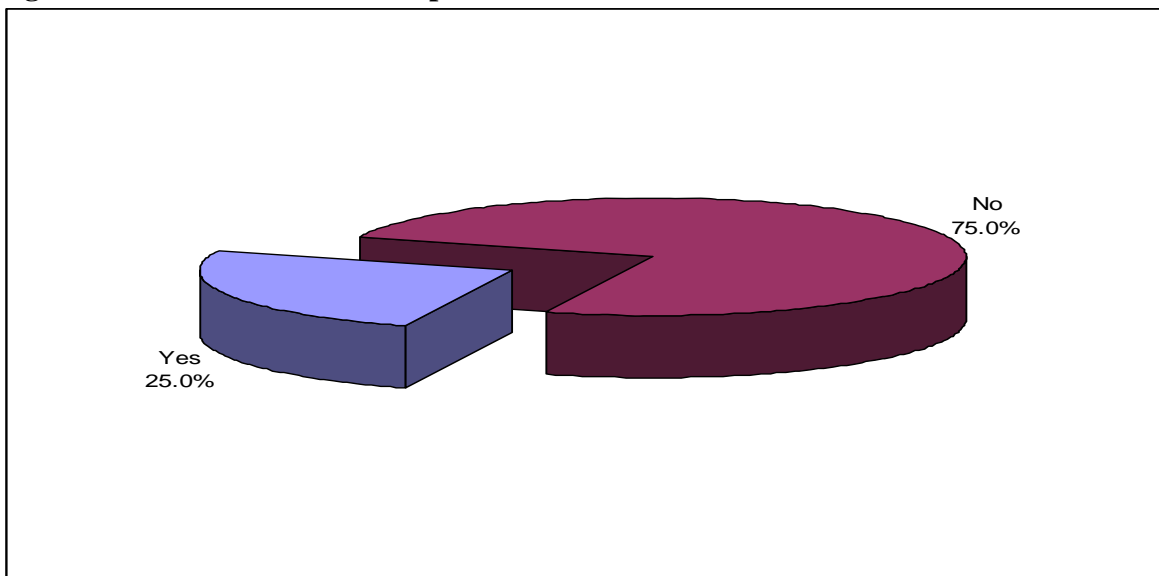
Source (Author 2011)

The respondents were required to state the time it took the bank to give them loan from end to end. Majority of the banks award loans to qualified application after one month, followed by 31.3% within three months, 21.9% over three months period and only 12.5% for less than one week period. The results were clear that financial institutions takes long time to have the loans given to the customers which is a challenge considering most of the loans are to meet urgent financial needs such working capital, acquire properties and expansion hence leaves the SMEs with no choice but to seek for additional funds from other sources, most preferably informal sources to bridge the gap.

4.3.9: Satisfaction with the process from start to the end.

It's important to determine if the SMEs were satisfied with the whole process considering the average time taken is 3 months for them to get a loan and a lot changes in the operating environment will have taken place, and according to the respondents as shown in figure 4.7, 75% felt that they were not satisfied with the process while only 25% were satisfied by the process. Of those who were not satisfied with the process, the respondents indicated that the most challenging stage of the loan process were; the period it took to process the loan, application and appraisal stage, loan approval stage 'I had to visit the institution six times and every time I was told to check another day'.

Figure 4.7: Satisfaction with the process from start to the end



Source (Author 2011)

It clearly shows that the respondents are not satisfied with the period taken and they expect a short period than is the case of three months now, this is because the SMEs to meet their financial obligations as at when they fall due, but with this period they are

faced with financial constraints that deprives the saving and in most cases are not able to get any benefits from this loans since they are overtaken by events and are of less help.

4.4: Coping mechanism used by SMEs

This section covers the findings from questions posed to the respondents on coping mechanism used by SMEs. From the finding it's a fact that the SMEs are faced with different challenges as they try to access finance such as inadequate collateral, time taken to give loan, lack of business proposal and much more. However, the SMEs in this town have to survive despite of these challenges and though only few do survive. For these SMEs to survive they have to adopt coping mechanism and the researcher wanted to establish if there are coping mechanisms that are employed by these SMEs.

Some of the coping mechanisms that SMEs use are; seeking finance from other sources of finance such as borrowing from friends, SACCOS, shylocks and saving. The results obtained from the respondents show that due to the difficulties the SMEs have sought other alternatives that they find easier to finance their operations or meet their financial obligations hustle free and in a short period than going for financing from financial institutions despite the fact that this sources sometimes are risky and expensive than the financial institution.

4.4.1: Are the financial institutions your preferred source of finance?

The researcher sought to know the most preferred sources, based on the earlier questions; the SMEs have preference on where they sought finance. The preferred sources can be termed as where majority of them seek financing. Based on response shown on the table 4.21 below, 50% of the respondents preferred financial institutions as sources of finance

while 50% not prefer financial institutions as a source of finance. This is the number that felt they would prefer other sources, despite the challenges faced by SMEs, it shows that they still prefer to borrow from financial institutions as opposed to other sources that are available. This is because financial institutions are considered safe and have high chances of surviving during hard economic times, it can also be attributed to the fact that most of the SMEs bank with different financial institution and take advantage of the existing relationship as well as ability to get services from one stop shop.

Table 4.9: Are the financial institutions your preferred source of finance?

	Frequency	Percent	Cumulative Percent
Yes	16	50.0	50.0
No	16	50.0	100.0
Total	32	100.0	

Source (Author 2011)

Table 4.10: Are the financial institutions your preferred source of finance * if not what alternatives source of funds do you have Cross tabulation

Are the financial institutions your preferred source of finance		If not what alternatives source of funds do you have				Total
		Friends and relatives	Own savings	Selling of properties	Others (Chama)	
No	Count	2	9	2	2	15
	%	13.3%	60.0%	13.3%	13.3%	100.0%
Total	Count	2	9	2	2	15
	%	13.3%	60.0%	13.3%	13.3%	100.0%

Source (Author 2011)

As a way of coping with the challenges, the researcher sought to know the alternative sources that are used by SMEs, especially those that do not prefer financial institutions as source of finance. It's important to establish the coping mechanism used or the available alternative sources like selling of properties, saving, borrowing from friends and informal sources. According to the results half of the respondents prefer other sources of finance as opposed to financial institutions and of those who did not prefer financial institutions as source of finance, 60% uses their own savings as source of funds, 13.3% preferred friends and relatives, selling of properties and Chama's as source of finance to finance their businesses. Based on the results majority of the SMEs use their own saving especially because own savings are considered less risky and reduces financial burden on the SMEs. The other alternative is use chamas which is most preferred because it enables

the SMEs to pool resources together where they can borrow in future with less restrictions and beside interest earned is shared between the members.

4.4.2: What have you done to be able to access finance easily?

Based on the challenges being experienced by SMEs, definitely they have done something to enable access finance, and the question sought to know if they have made any effort to ensure that they access finance and what they have done. Most of the respondents have sought other ways of accessing finance, especially because they don't understand the operations of financial institutions. As shown in table 4.11, 46.9% of the respondents had consulted a financial specialist, 43.8% had consulted the bank officer and only 9.4% had applied for finance in another institution to be able to access finance easily. Most of the respondents have consulted financial specialist because they are easily accessible and their opinions are independent. Other respondents have consulted bank officers whose advice come free and also understand the requirements and the whole process from application to drawdown.

Table 4.11: What have you done to be able to access finance easily?

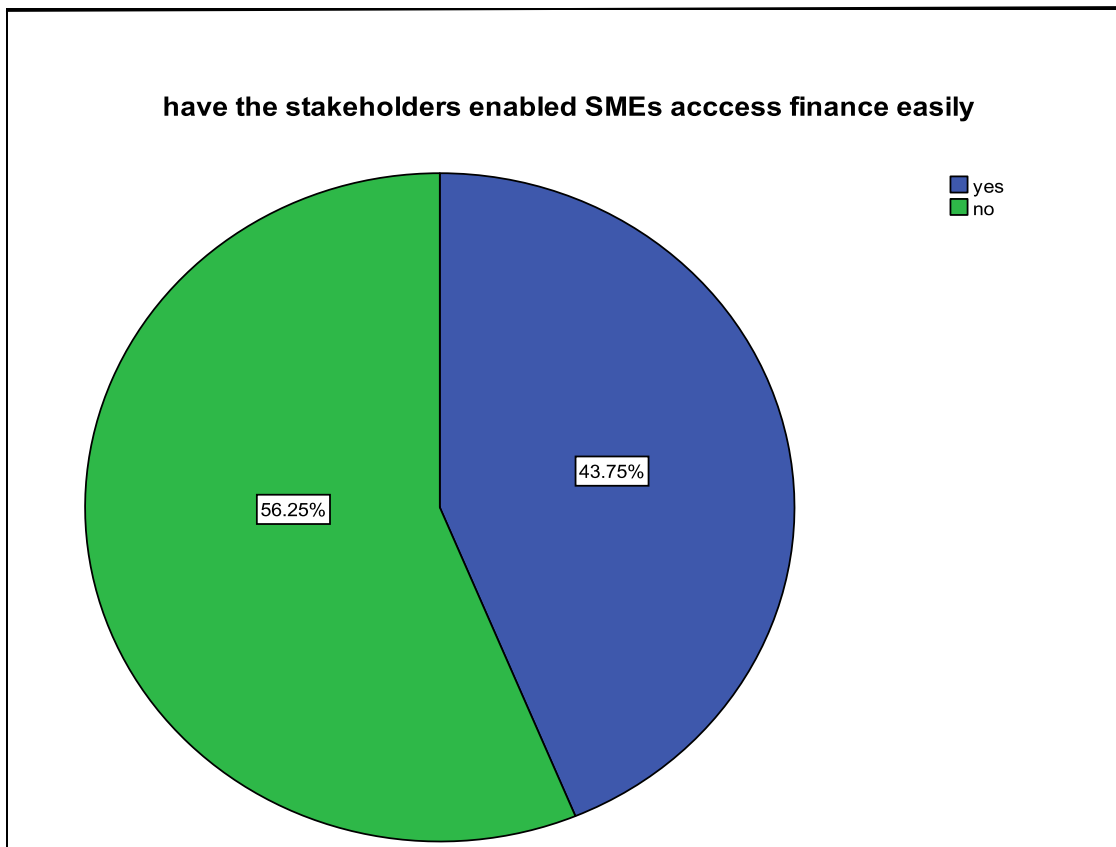
	Frequency	Percent	Cumulative Percent
Consulted a financial specialist	15	46.9	46.9
Consulted the bank officer	14	43.8	90.6
Applied for finance in another institutions	3	9.4	100.0
Total	32	100.0	

Source (Author 2011)

4.4.3: Influence of stakeholders in enabling SMEs access finance easily.

There are stakeholders who are supposed to make access of finance of easier and they include government, international donors, banks and society. In this question the researcher wanted to establish if the effort being put by these stakeholders is helping the SMEs access finance. The various ways in which the stakeholders in the SMEs sector use are includes lobbying government and donor intervention, however its important to determine if this has helped the SMEs

Figure 4.8: Have the stakeholders enabled SMEs access finance easily



Source (2011)

As indicated in figure 4.8, 43.75% of the respondents felt that stakeholders have enabled SMEs to access finance easily. On the other hand 53.75% were of the opinion that

stakeholders have not enabled SMEs to access finance easily and this shows that a lot still need to be done in order to help the SMEs access finance. The various suggestion include creation of third party guarantees from government, acceptance of different instruments as collateral security like bonds, LPO financing, strengthening and giving incentives to the SMEs to list in the stock market as this would give the SMEs alternative sources of financing instead of relying on the traditional methods.

4.5 Discussion.

The researcher identified that most of the respondents are married and are educated, have the requisite documents required by law and operate account with financial institutions, however they still face similar challenges when accessing finance. According to the response they face challenges such as banks taking long to have the loan disbursed which eventually leaves them unable to meet their financial obligations. They also lack sufficient collateral, strict conditions that most of the SMEs are not able to meet therefore delaying the whole process of loan application.

In their response to the questionnaire they suggested government intervention as one of the fundamental way of resolving their challenges, others like issuing counter guarantees, strengthening of other institutions that give preference treatment to SMEs. The response from SMEs also clearly indicates that they prefer to use other alternatives sources of finance and have derived various coping mechanism used to manage challenges faced they face in accessing finance; saving and trying to reduce expenses, attending financial seminars, use of merry go rounds, borrowing from friends at zero interest rates, reducing credit period for the firm's creditors, obtaining credit facilities from suppliers, ploughing back profits, offering stock as security, consulting with other SMEs owners, joining

Sacco, using credit cards and overdrafts. Most of the coping mechanisms cited are expensive and not sustainable in the long run, and have put the SMEs in serious financial crisis with most of them not surviving to celebrate the 5th birthday which adversely affect the country's economic position. In conclusion, its no doubt that SMEs operate in an environment that poses a lot of challenges that are beyond their control and stakeholder's intervention is urgently required otherwise it will jeopardise the country's economic goals.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the findings, conclusions and recommendations of the study. It also presents the proposed future studies that would widen the knowledge base of challenges faced by small and medium enterprises in accessing finance in Kenya

5.2 Summary

The objectives of the study were to determine challenges facing SMEs operating in Kiambu town in accessing finance and to establishing the coping mechanism employed by SMEs operating in Kiambu town in managing these challenges. Foremost, the study found that most of the firms had legal documents required by the law for trading purposes. More so the available documents across the firms were; Kenya Revenue Authority documents such as VAT registration certificate, PIN certificate, tax compliance certificate and annual tax returns. City council of Nairobi documents available were; city council single business permit. On the same note respondents unanimously stated that they hold and operate bank accounts.

The study further found that majority of SMEs relied on funds from financial institutions to finance their operations, that is, 84.38% of the respondents had borrowed funds from financial institutions to finance their business. It was also noted that SMEs do face problems when accessing funds. The problems faced by SMEs were insufficient collateral (71.4%) and Business proposal not acceptable (21.4%). other the reasons for

partial awards were; direct income ratio, lack of security, lack of payment capability from my bank statement, it was first time borrowing so the financier awarded less than the amount applied for, other outstanding loans from other financiers and lack of audited books. The study findings indicated that the most challenging stage of the loan process were; the period it took to process the loan, application and appraisal stage, loan approval stage 'I had to visit the institution six times and every time I was told to check another day' said a respondent.

In terms of coping mechanism used to manage challenges faced by SMES in accessing finance, the study identified the following; saving and trying to reduce expenses, attending financial seminars, use of merry go rounds, borrowing from fiends at zero interest rates, reducing credit period for the firm's creditors, obtaining credit facilities from suppliers, ploughing back profits, offering stock as security, consulting with other SMEs owners, joining Sacco, using credit cards and overdrafts.

5.3 Conclusion

SME are considered to have a crucial role in an economy and are key source of economic growth, dynamism and flexibility and can adapt quickly to changing market demand and supply situations. They also deemed to generate employment, help diversifying economic activity and make significant contribution to export trade. Roles of SME sector to the development process are also highly relevant to small developing economies like Kenya considering its small domestic market, weak and narrow based economy against volatile global environment.

However, inadequacies in access to finance are one of the key obstacles to SME growth,

not only in developing countries, the research has clearly demonstrated that SME are usually more credit constrained than other segments of the economy because of financial sector policy distortions, lack of collateral, information asymmetries, lack of sufficient collateral as well as high risks inherent in lending to SMEs.

In addition to the above mentioned constraints of lack of access to finance to SMEs, the research has revealed one characteristic that SME are more disadvantaged in obtaining external finance. Developing countries like Kenya have economic imbalances that lead to excess demand for available domestic savings as well as institutional weakness that encourage large number of individuals to engage in low productivity informal activity. Therefore government action is necessary to correct market failures, and also assist potential start-ups and disadvantaged groups in society.

5.4 Recommendations

First, the government should provide specific laws restricting and clarifying and therefore, offering certain types of financial contracts or financial business, including factoring, venture capital, structured finance, credit guarantee system, and credit information bureau.

Second, there is need to improve financial information infrastructure. Better coordination between existing Credit Information Bureau and the industry will be important to ensure development of an information system which will effectively serve SME need. The government should also urgently expedite the process of providing laws and regulations on increased use of e-banking. Banks are offering new products and services through e-

banking and bank cards to shorten loan application processes, ease bank account enquiries and facilitate payments of consumer goods and utility bills.

The government and donor programs to improve access to financial services for SME and should be designed to ensure that these services are sustainable on market principles after completion of the programs. Lastly, the stakeholders should urgently establish a Credit Guarantee System. It should be based on the following criteria for evaluating CGS risk sharing among the CGS, borrowers, and banks. CGS should obtain whatever collateral is available from the borrower and should pursue loan recovery vigorously, even after the guarantee has been paid out. CGS should be designed so that fees and other income, such as the return on investments, cover all administrative costs and claims. Minimum of 5 percent default rate is the point at which action may be considered to remedy the situation.

5.5 Limitation of the Study

The study like other research studies had limitations in that the time set was short. The cost of carrying out the research was another limitation since it was self sponsored. Financial expenses of travelling from library to another to obtain the right materials write up and binding were a problem. Finally some respondents were uncooperative as some of them were busy during the working hours and could not get time for my questions

5.6 Suggestions for Future Studies

This study focused on challenges faced by small & medium enterprises in accessing finance in Kiambu town, Kenya. It is therefore recommended that further research work should look at other parts of the country and the results compared. There should also be

study to identify the other challenges faced by SMEs and also identify the necessary steps that can be undertaken by stakeholders to manage the challenges identified.

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APPENDICES

APPENDIX ONE: QUESTIONNAIRE

Please answer freely the questions below. The information provided will be treated with the highest degree of confidence. When the questionnaire is completed, it should be submitted to the researcher.

Section A: Background Information

1. Sex

- a) Male ()
- b) Female ()

2. Marital Status

- a) Single ()
- b) Married ()
- c) Divorced ()
- d) Separated ()

3. Level of education

- a) Informal Education ()
- b) Primary ()
- c) Secondary ()
- d) College ()
- e) University ()

4. Name of your business -----

5. What position do you hold in the organization (optional) -----

6. When did your firm start business -----

7. What type of business organization is your firm? Tick where appropriate

Sole Proprietor { } Partnership { } Limited Company { }

14. Did the financier give the loan that you applied?

Yes { }

No { }

15. If no, what were your problem(s)?

a) Insufficient collateral

b) Poor documentation

c) Business proposal not acceptable

d) Previous credit record

e) Own contribution too small

f) Lack of financial statements

g) Other (please specify) _____

16. If yes, did the financier give full amount of loan applied? If not what was the reasons for giving less than applied? Yes [] No []

17. Were you able to meet all the conditions required by the Bank?

Yes { }

No { }

18. In your opinion what requirement (s) was (were) difficult to fulfill to enable you get the loan?

a) -----

b) -----

c) -----

19. Did you fulfil all the condition(s) above or how was requirement waived?

Yes { }

No { }

20. How long did it take the bank to give the loan?

Less than a week [] One Month [] Three Months [] Over 3 months []

21. In your opinion, were you satisfied with the process from start to the end?

Yes []

No []

22. If no, what would cite as the most challenging stage of the loan process?

Section C: The coping mechanism used by SMEs

23. Are the financial institutions your preferred source of finance?

Yes { } No{ }

24. If not, what alternative source of funds do you have?

- a. Friends & Relatives
- b. Own Saving
- c. Selling of properties
- d. Any other, please explain

25. What have you done to be able to access finance easily?

- a. Consulted a financial specialist
- b. Consulted the Bank Officer
- c. Applied for finance in another institutions
- d. Any other

26. Have the stakeholders enabled SMEs access finance easily? What more can be done to enable SMEs access to credit?

Yes { } No { }

Explain

27. What other coping mechanisms do you use in your business towards the challenges of accessing finance? Please give examples.
