

**CHALLENGES FACING COMMERCIAL BANKS IN CREDIT
FINANCING OF SMALL AND MEDIUM MICRO ENTERPRISES
WITHIN KISUMU TOWN.**

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DECLARATION

This research is my own original work and has not been presented previously in part or in its entirety at any other University towards the award of a degree

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ABBREVIATIONS

SMEs	Small and Medium Enterprises
GDP	Gross Domestic Product
OECD	Organization for Economic Co-operation and Development Centre
ADB	African Development Bank
DCA	Development Credit Authority
FSD	Financial Sector Deepening
USA	United States of America
CBK	Central Bank of Kenya
CBS	Central Bureau of Statistics
NSE	Nairobi Stock Exchange

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ABSTRACT

Small and medium scale enterprises are the backbone of many successful developed and developing nations. However in most developing economies SMEs contribution has not reached a level on par with SMEs in developed countries. Various challenges and impediments prevent SMEs from developing to their full potential. One of which is the access to formal financing.

This study sought to determine the factors that inhibit SME lending by commercial banks and gave recommendations on how these could be turned into opportunities.

It was found out that most commercial banks are risk adverse lending to informationally opaque SME. As a result they ask for many requirements to enable them gather at least reliable information to enable them evaluate their decisions on lending to this sector. Contrary SME owners are unable to provide what banks want. The poor information environment in many developing countries does not help either. However a positive trend is developing among commercial banks towards serving the SME sector. This is possible because of the credit referencing bureau and the application of credit scoring to SME loans.

The research found out that the key challenges commercial banks faces in financing SMEs were among others that SMEs lack proper books of accounts, lack collateral, and their inability to prove their credit worthiness.

The research concludes with several recommendations that could facilitate greater access to finance by SMEs. This includes among others the reforms in the countries lending structure improving the information sharing among commercial Banks and embracing other forms of collateral rather than the insisting on the immovable assets. Banks also need to venture into products that will serve the SMEs more effectively.

CHAPTER ONE: INTRODUCTION

1.1 Background of the study

The micro, small and medium enterprises (SMEs) industry has for a long time been the buzz word in the world economy. It has been touted as the panacea to the growth of both the developing and developed economies. Thus the well being of these firms is necessary for a country's future success. While large corporations of the world are taking their countries forward on rapid innovation and development, it is small businesses that play a vital role in the grassroots development, contributing to a more equitable growth. Kenyan small businesses are no different.

It still plays an important role in the provision of employment and contribution to the developed world's Gross Domestic Product (GDP). Kenya which is considered as a market economy relies heavily on SMEs to provide the much needed employment. The development of the private sector varies greatly throughout Africa. In South Africa, Mauritius and North Africa, SMEs are flourishing because of their fairly modern financial systems. Senegal and Kenya have created conditions for private sector growth but are still held back by an inadequate financial system, OECD Policy No.7

Fair access to credit and banking services is a ladder to development and poverty reduction for both developing and developed economies. Access to a bank account gives an individual greater control and security over their money and a loan from a credit organization can be vital in promoting enterprise development. Banks need to address the needs of these SMEs so that they can also grow and expand since they can be a major driver in the growth of the economy.

Financing resources are typically in short supply in developing countries and economies, thus support measures of SME have limited outreach at high cost and financial intermediaries favor large enterprises. Further, institutional limitations such as underdeveloped or inefficient legal framework and regulatory infrastructure pose significant barriers to achieve financing. As a result, SMEs share of available financing resources is disproportionately less than their relative contribution to employment, value added and economic growth.

SME are considered the engine of economic growth in most of the developing economies,

by virtue of their sheer number and significant economic and social contributions. In countries such as Japan, China, Taiwan and South Korea, SME are the back bone of the industrial and manufacturing sector. Their number and contribution to the total employment in these economies are well over 95% and 70% respectively (RAM consultancy services SDN Bhd, 2005)

In 1999, there were approximately 1.3 million small and medium enterprises creating employment for 2.3 million people of these only 9,041 fell into the 11 – 50 employees. This lack of enterprises in bracket comprises of the missing middle of the SME sector in Kenya (Central Bureau of Statistics 1999).

In Kenya there are two major challenges that currently face the SMEs sector, thus hindering their growth. Lack of supportive governance frame work. First is lack of a proper legal framework that protects their interest, harassment from local authorities, exposure to corruption, unenforceable contracts and unsupportive tax regime. Second is lack of access to credit facilities. Credit constraints operate in a 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 small enterprises forces them to rely on high cost short term finance.

There are other various financial challenges that face small enterprises. They include the high cost of credit, high bank charges and fees. The scenario witnessed in Kenya particularly during the climax of the year 2008 testifies the need for credit among the common and low earning entrepreneurs. Numerous money lenders i.e. Pyramid schemes came up promising hope among the little investors that they could make it to the financial freedom through soft borrowing. The rationale behind turning to these schemes among a good number of entrepreneurs is mainly to Seek alternatives and soft credit with low interest rates while making profits. Financial constraints remain a major challenge facing SMEs in Kenya (Wanjohi and Muguru 2008).

Credit rationing in the Kenyan formal sector credit market emerges as another constraint on SMEs growth. However, credit rationing is an SME- Specific constraint that is not binding on large firms. On the other hand credit rationing is a consequence of constraints on both supply and demand. Supply –side constraints arise because of weak and poorly enforced creditor rights, because of the high per unit cost of SME lending and because of SMEs

weak reputation and financial systems. Demand- side constraints arise because loan disbursements procedures are excessively time consuming and because the collateral requirements prescribed by banks raise the cost of access to credit for SMEs.

Banks have in the recent, however, developed financial products tailored to segmented customer products. Majorly the products are tailored to consumers in business banking, retail banking, personal banking and SME banking.

Banks in Kenya by the mere fact that they are commercial in nature and because of the level of risk involved are forced to charge high interest rates, require high value collateral, financial statements, insurance cover for the facilities sought, which eventually increase the transaction costs for the SMEs.

The term SME covers a wide range of definitions and measures, ranging from country to country and between the sources reporting SME statistics. Although there is no universally agreed definition of SME, some of the commonly used criteria are the number of employees, value of assets, value of sales and size of capital as well as turnover. Among them, the most common definition basis used is number of employees because of the comparatively ease of collecting information and here again there is variation in defining the upper and lower size limit of an SME. In the context of Kenya, micro enterprises are those engaged in up to 4 people, in most cases family members and employing capital amounting to Kshs. 300,000, the majority of micro enterprises fall under the informal sector. Small enterprises are mostly formalized undertakings engaging between 5 and 49 employees or with capital investment from Kshs. 300,000 to 50 million. Medium enterprises employ between 50 and 99 people or use capital investment from Kshs. 50 million to 800 Million.

Credit is the trust which allows one party to provide resources to another party where the second party does not reimburse the first party immediately (there by generating a debt), but arranges to pay at a later date. The resources provided may be financial e.g. granting a loan, goods or services e.g. consumer credit. Thus credit encompasses any form of deferred payment.

Movement of financial capital normally is dependent on either credit or equity transfers. Credit is in turn dependent on the reputation or creditworthiness of the entity which takes responsibility for the funds. Credit is also traded in financial markets.

Trade credit in commercial trade refers to the approval for delayed payments for purchased goods. Companies frequently offer credit to their customers as part of terms of purchase agreement. Consumer credit is money, goods or services provided to an individual in lieu of payment. Common form of this includes; credit cards, store cards, personal loans, retail loans and mortgages.

1.2 Statement of the problem

Formal financial institutions in Kenya shy away from SMEs because they consider them too risky and costly to serve. Thus, lack of working capital, access to credit and access to market for their products have been established as the major constraints that cause business closures of SMEs (Rukwaro 2001). Commercial banks have introduced the SME banking concept but they have not got to examine the real needs of SMEs, challenges they face in trying to lend this funds and the suitable methods that they can use to satisfy the financial needs of this sector. Some banks, the prevailing mindset is still one of “bigger is better”. As a result they demand collateral, require onerous documentation and subject the SME to the same evaluation criterion as the large and structured corporations. Non bank financial institutions and micro finance are usually found to be more perceptive and knowledgeable about SME financing. They have played a greater role in the provision of credit and other services but under stringent credit terms which do not favors most SMEs.

Helmsing and Kolstee (1993) clearly indicates that despite SMEs perceived importance in generating employment and in production, the SME sector in Kenya has very inadequate access to credit. Previous studies clearly points out that a large number of Kenyans are dependent on SMEs. Thus, this sector is a major means source of employment, growth and poverty reduction. Despite all these, access to financial service from Commercial Banks is still low. Most finance comes from informal sources and is limited. Studies have been done in the sectors of small and medium enterprises locally and internationally and all have concluded that, the SME sector is the backbone of both developing and developed economies.

Locally, however little has been done to discuss concurrently constraints faced by both the supply and demand of financial services in SMEs. Wasonga (2008) focused his study on the challenges faced in financing SMEs in Kenya. The study focuses on the supply side

with no regard to the demand side. Mwaki (2006) focuses her study on the financial structure and growth of SMEs. The study assess the growth of SMEs but fails to deal with the challenges this business faces in accessing finance from the formal institutions. Githinji (2010) focuses on the relationship between the credit scoring practices by commercial banks and access to credit by SMEs in Kenya. She fails to consider the particular element that disqualifies an SME to access funds.

Nduba (2010) focuses on factors that determine credit worthiness of SMEs for bank loans without due regards to challenges commercial banks face in providing credit to SMES. As a result there is need to carry out intensive research on the constraints that faces both the supply and demand of SMEs in accessing and financing them, how to address these and the specific banking needs required by the SMEs to expand and manage their operations.

This study intends to determine the constraints commercial banks in financing SMEs. The study undertakes to also answer the following: What requirements do commercial banks need in SME loan assessment? Which Challenges do commercial banks face in SME financing? How do banks address this? The study will also cover the challenges that are inherent to SMEs themselves.

1.3 The Objectives of the study

The objective of the study is to determine the constraints faced by commercial banks in financing SMEs within Kisumu town.

1.5 Value of the study

The study will be of immense importance to a number of bodies given the importance of the SME sector in the economic growth, the following are some of the expected gainers of the study.

As a backbone of the economic development, it will assist the government in coming up with policies formulation aimed at serving the SMEs better, to encourage their growth that will result in stimulating economic development and hence create more employment opportunities.

The study focuses on the challenges in commercial banks and SMEs sector. This will make the financial institutions in reviewing their lending policies and restructure their lending

approaches having gained an insight of the SME sector. This will include among other innovations, coming up with new products, partnering with other bodies and institutions like insurance, World Bank etc to serve this sector more informally.

The owners of SMEs will be empowered with information on the various alternative sources of funds available to them and the requirement by the financial institutions to extend credit to them.

The findings in the study will point out the gap the academia community needs to fill in order to foster increased availability of bank credit for SMEs. Therefore this study will form the basis for future research to improve access to bank finance for SMEs.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction.

Small and medium-sized enterprises account for over 95% of firms and 80% of the employment of the employable population. They have specific strengths and weaknesses that may require special policy responses (African Development Bank, ADB, 2004/2005). As new technologies and globalization reduce the importance of economies of scale in many activities, the potential contributions of smaller firms is enhanced. In this chapter, we review literature guided by the objective of the study which is to examine the constraints facing SMEs financing. A review of the requirements needed by commercial banks in financing the SME sector will be undertaken with interest of coming up with a more suitable balanced one.

2.2 SMEs economic contributions.

SMEs contribution to Kenya's economy has been studied by ILO (1972), McCarrick (1998), Parker, and Torress (1994), Denieis et al (1995) and King (1996). According to Machos et al (1999), the employment in the informal sector has been raising where as the formal sector has been decreasing. The informal sector contributed 94.3% of all the new jobs created outside the small-scale agriculture in 2003. Employment in the modern sector grew by 1.6% compared with the growth of 1.3% in 2001 (Economic survey, 2004).

2.3 SME Financing Review

2.3.1 Small and medium enterprises financing.

SMEs are vital in promoting economic growth competitiveness, entrepreneurship and innovation, and in creating new jobs. Kauffmann (2005) and Cousin (2007) noted that SMEs faces many obstacles in accessing suitable financial services. This is especially for the growth of innovative SMEs whose technology business models are not understood by traditional financial institutions and start-up enterprises, which lack a track record and collateral against which to raise debt financing.

The access of SMEs to external finance has attracted much attention from academics and

policy makers worldwide. The availability of credit for SME depends significant on the nation's financial structure and its accompanying lending instructions and technologies. Through these mechanisms, government policies and financial structures influence the level of credit available, Berger and Udell (2006). They noted that lending infrastructure ranges from the information, tax, legal, judicial and bankruptcy environment to the social and regulatory environments. They believe that all of these elements may affect SME credit availability by influencing the extent to which the different lending technologies may be legally and profitably employed.

SME banking is an industry in transition. From a market that was considered too difficult to serve, it has now become a strategic target of banks worldwide. The 'missing middle' describing the gap in financial services provided to SMEs is shrinking, Ono (2005)

Traditionally, SMEs have been financed to a great extend by internal sources both from the business owner and through retained profit. However to enable them grow higher, there is need to make them access to more formal mode of finance such as bank loans, leasing, trade credits, and factoring. Venture capital and funds of business angels are only important for a select group of high potential SMEs like seeders/start-ups, gazelles and management buy-outs and buy-ins, Staley and Morse, (1965)

In the recent past, presence of SMEs in the major cities in the less developed countries is no longer an issue of dispute among stakeholders. In a World Bank study on lending to SME projects, three major objectives were more frequently cited; creating employment and income opportunities through creation and expansion of SMEs to increase the activity and income of vulnerable groups. World Bank Report (2001) states that 80% of the world's 4.5 billion people living in low and lower middle income economies do not have access to formal sector financing.

2.3.2 Sources of SME Financing

SMEs draw financing from a variety of sources. Wasonga (2008) notes that 75% – 90% of Kenyan SMEs, rely on internal savings retained earnings and borrowing from family friends and money lenders (informal sector). This is opposed to the 3% – 18% which have access to formal sector financing (banks, venture capitalists etc). Thus compared to the

number of people employed in the sector, 80% of the total workforce, is of high concern to policy formulators and financial providers both government and private. Suffice to say that SME in Kenya, like in other developing countries, generally have not been successful in tapping funds from the formal financial sector. If they did, it is usually at a relatively high cost.

2.3.3 Government programmes for SME financing

The government of Kenya has actively participated in promoting SME development in the last two decades. However the general consensus is that the governments in the LDC have not exploited their programmes and support to the SME fully as originally intended. This is indicated by the low contribution of the SME sector towards the country's GDP, only 20% contribution to value added

Through CBK, the government has lowered the interest rate to banks borrowing from it. The target is for the banks to also follow suit and lower the base lending rate, which most banks have done, CBK Report (2009)

The minister for finance through the Finance Bill for the fiscal year 2010/2011, reiterated the role of SMEs in promoting Kenya's sustainable development. The minister established a revolving fund of Kshs. 3.8 billion through which the government will enter into a credit facility agreement with banks to support SMEs. Through this partnership, the government expects banks to maintain Kshs 5 at the minimum for every Kshs.1 invested by the government to expand the fund five-fold to Kshs.15 billion at the minimum. The government has through CBK and other players initiated a number of policies and regulatory reforms geared towards addressing the challenges experienced by the promoters of SMEs, that is making them banked and to enjoy financial services fully CBK Governor (2009).

- (i) The licensing and regulation of deposit taking micro finance institutions by the CBK.
- (ii) Initiative of new banking models such as agent banking in 2009, which brings banking services closer to the consumers.

- (iii) The introduction of credit information sharing enables SMEs to build information capital that they can use as collateral.

Financial programmes in Kenya funded by international agencies are the most successful ones. These agencies work in conjunction with government ministries and agencies to administer various lending programmes to SMEs. USAID Kenya nurtures SMEs by helping them in production and marketing, and supporting policies that encourage small businesses, USAID Kenya (2010)

The ultimate goal of USAID's Development Credit Authority (DCA) program is to change lenders behaviour by demonstrating the creditworthiness of SMEs. It does this through the sharing of credit risk and bridging with Kenyan financial institutions to encourage lending in underserved area due to the perception of high risks (USAID 2010)

2.3.4 Banking Sector Financing.

Notwithstanding the low penetrations, financing by banking institutions form the most important source of external financing for SMEs. This is due to the dominance of the banking sector as the main intermediary in the financial system of Kenya.

The SMEs banking sector is best defined conceptually by its position between large corporations and mostly–informal micro-enterprises. The development of a commercial banking sector in many countries began with addressing the needs of large corporate clients. This model has historically consisted of managing very high-value transactions for a small number of low-risk clients. Outside commercial banking sector, micro financial institutions arose to offer working capital loans to micro-enterprises typically ranging from medium amounts in \$ 150 in South Asia to \$ 1,600 in Eastern Europe, Ngige (2010)

SMEs finance is referred to as the “missing middle” because their financial requirements are too great for most micro financial institutions and SMEs have been viewed as too small or costly for traditional commercial banks, Jetro (2005).

Collier (2009) noted that African banks had just started to show interest in SMEs when the global credits reversed the tide. The risk for SMEs is that they will suddenly be barred access to credit whereas they need long-term financing more than ever before and Africa's

financial systems are unable to meet this demand. This situation will only improve if there is a better dissemination of information on sub-Saharan Africa's markets that would make it easier for investors to identify high-quality small and medium enterprises. An appropriate use of new information technology should provide a solution, Ngige (2010). Lending technologies include information on which financial institutions rely upon to determine the supply of debt finance to firms while simultaneously addressing opacity problems. Current frameworks of lending technologies consist of two categories one is transaction lending which is mainly based on the quantitative data. The other is relationship lending that is largely based on qualitative information, information gathered through continuous contact with the firm that wants the provision of financial services, Berger and Udell (1995). Financial theories have traditionally been developed to explain capital structure with empirical evidence, mainly based on large listed firms, Cassar and Holmes (2003). The literature has therefore attracted a number of studies focusing on gathering data from small firms to explore if these arguments are also valid when applying them to institutional and large-scale settings.

A financial gap arise because the demand from small firms exceeds the willingness of financial institutions to supply the finance at the current market conditions, a situation recognized decades ago in the report of the Macmillan Committee (1931). Today's shortage of finance has been reported as a particular problem for SME in different stages of development and has attracted more attention from government policy makers and academics, Fischer (1995).

In the USA SMEs, particularly constrained firms are vulnerable to business cycle fluctuations and more susceptible to credit rationing. Equity and net debt are correlated for small firms. In contrast, in large firms net equity and net debt are not correlated and not cyclical. The criteria for bank lending to SMEs in Eurozone are cyclical as well. During the stages of downswing and recession the criteria are tightened and the change is larger than the change in demand for bank loans, Ngige (2010).

2.3.5. Relationship between Banks and SMEs

Relationship banking is defined by Moriarty et al. (1983) as recognition that the bank can

increase its earnings by maximizing the profitability of the total customer relationship over time, rather than seeking to extract the most profit from any individual product or transaction. Such an emphasis is in keeping with the dominant trend in business- a shift from a transaction orientation to one long long-term interactive relationship. Small firms and banks however despite their importance to each other in economic and social development, experience relationship difficulties.

The relationship between and small business is invariably a long term one and the extent to which a bank can meet its customers needs effectively is heavily dependent on the willingness of the customer to provide appropriate information, Binks and Ennew (1996). This need is evidence particularly in lending decision. Further, building effective and successful relationships can contribute significantly to customer satisfaction, loyalty and retention and thus to improve performance.

Banks and small firms find it difficult to develop good working relationship because of their different characteristics and experience. Following Mintzberg's classic categorization of organization organizations structures, the bank is a "machine bureaucracy" wherein rules and regulations tend to supersede managerial discretion. Decision are reutilized, unanticipated problems upset systems and managers, Butler and Durkin (1998). In contrast to this, the typical entrepreneurial small firm is organic and informal- the "simple structure". The owner-manager makes his or her own decisions, usually quickly, and often intuitively.

A further understanding of the problem between bank officials and entrepreneurs can be found in terms of empathy. There is a profound difference in the realities of daily working lives of both actors. The branch manager- whom most small business owner contact, has been socialized in process- procedure and standardization of work. This leads the bank manager to tend to analyze, prioritize and impose a particular kind of order on the small firm who's internal and external environments are radically different from those of the bank. This is the opposite of the entrepreneurs view and understanding of the world and of what makes a successful manager, Butler and Durkin (1998)

2.4 An Overview of Empirical studies-Constraints faced by SME Owners (Demand)

2.4.1 Information Asymmetry.

Information asymmetry between the entrepreneurs and bankers is one of the factors that SMEs faces while attempting to raise finance from banks. Most SMEs evolve in the informal sector and are therefore not in a position to give banks the minimum information they generally require. Formal financial institutions demand for details such as contacts, financial statements legal documentation such as licenses. For those in the formal sector, the absence of accounting and the lack of independent, competent and credible accounting firms, have an impact on the quality of financial information given to banks, Kauffmann (2005). SMEs do not have audited financial statement to yield credible information on a regular basis. They also do not have publicly traded equity, Ochieng (2008).

This strong information asymmetry, which cannot be offset by satisfactory securing loans, has two significant implications. First it increase transaction costs which given the low level of committed amounts of loans, leads to a problem of economies of scale. Second it leads to inaccurate risk assessments with risks often being overestimated by banks. This prompts banks to avoid these counterparties or offer rates which are too high, Kauffman (2005)

2.4.2 Bank Requisition for Collateral.

Collateral is a principal of sound banking practice and is one of the criteria for assessing risk under prudential guidelines. Most SMEs in Kenya lack fixed assets which they can pledge as security for loan application in banks. The banks insistence on immovable assets as collateral locks out more SMEs who have movable properties that they could pledge as security. Lenders have not been innovative in considering other forms of collateral. There is a tendency to rely on traditional all asset debenture and legal mortgages at the expense of less costly and more innovative financial products, FSD Kenya (2009).

Almost 90% of firms with loans are required to post collateral, these percentages being amount the highest of all comparator countries, FSD Kenya (2009).

It is costly and time consuming to create and perfect collateral in Kenya. It takes an average

at 90 days for mortgage collateral and more than 21 days to perfect a security interest in equipment, not including the time taken to approve the loan and the collateral in each case. Each process cost over 5% of the loan amount, and expense which often must be pre-paid by the borrower. A worrying aspect is that the benefits of collateral are not accruing to borrowers, FSD Kenya (2009)

2.4.3 Inability to prepare required Business Plan

SMEs lack the capacity to employ specialized persons in the field such as financial planning, business planning, preparation and interpretation of financial statements. To this, they might have good plans but lack the implementation strategy. Likewise most financial statements are prepared by accountants with the aim of securing a loan without giving due regard to the business performance in all aspect. Thus lack of manpower in specific field hinders their ability to make correct decision about their business performance and demands at various stages, Nduba (2010)

2.4.4 Stringent Documentation and High Interest Rates.

Financing the SMEs in Kenya is considered risky and as a result they are charged highly on loans. An average of 1.97% of the loans value for small firms and 1.79% for medium sized firms are generally almost twice as high as in other countries in terms of fees payment, Ngige (2010). SMEs loans in the region appear to be riskier than those in other developing countries. This may be due to the high interest rates observed in Africa, Ngige (2010).

The loan processing in many financial institutions may be quite complicated onerous and lengthy for SME. This is especially the case for borrowers requiring small amount of loans.

2.5. Constraints faced by Suppliers of Finance to SMEs (Commercial banks) Empirical studies.

2.5.1 Bank Requisition of Collateral.

According to the banking Act, the lender is not obliged to lend against security. The guidelines there in provide that where securities are obtained, they should be perfected in all respects, namely: Duly charged and registered, adequately insured, valued by a

registered value, perfected in all other areas specified in the letter of offer of the facility. All these requirements are time consuming and costly on both the banks and borrower. Most banks insist on the immovable assets as collateral to the finance loans advanced. However, most of the SME owners lack the facility forcing banks either to rely on other facilities to advance the loan or reject the application at all. This has rationed on the number of SMEs most banks could have granted credit using movable properties because it is difficult to monitor and because of the weak judicial enforcement in recovering of the assets pledged as a security. Poorly enforced creditor rights seriously hinder SME lending. This is as a result of ineffectual judicial enforcement. There is need to provide for the right of foreclosure and sale of mortgages property with or without court intervention, as well as transfer of cases to execution, FSD Kenya (2009).

According to Lehmann and Neuberger (2001), banks view collateral as having incentive and signaling effects, which solve moral and adverse selection problems under asymmetric information. Thus borrowers won't choose riskier projects when they pledge collateral

2.5.2 Credit Risk Management

Stanghellini (2003) observed that consumer credit is any of the many forms of commerce under which an individual obtains goods or services on condition of a promise to pay for their value, along with a fee (interest), at some specific future date. He further acknowledges that the need to cope up with a vast demand for credits forced the lenders to implement automatic techniques for deciding with to lend loan or not.

Risk is exposure to a proposition of which one is uncertain Holton, (2004). The Basel Committee (1999) states that a number of major world's commercial banks have developed sophisticated systems to quantify and aggregate credit risk upon which their lending is determined.

Credit risk management refers to the systems, procedures and controls which a company has in place in to ensure the efficient collection of customer payments and minimize the risk of default, McMenomin (1999).

SMEs are perceived as being more risky than big companies'. They present a high

sensitivity to economic shocks, Nduba (2010). Thus, allotting medium and long-term credits to these firms becomes problematic. In additions, monitoring costs reach unacceptable high levels as compared to the value of the granted credit. Credit risk is therefore a potential cost to the bank. Thus in theory, banks should set higher loan rates for higher borrower's risk.

Credit risk management is a continuous process. Modura and Theodore (1998), stated that the credit worthiness' of customers can change over time, so it should be evaluated periodically using updated information. Post sanction monitoring comprises tracking the respective clients' compliance to the sanction terms of the loan proposal.

2.5.3 Bank Lending Culture

Binks, Ennew and Reed (1990), also identified a gap in the financing of SMEs which they argued might be closed if banks were willing to lend on the basis of future cash flows. This, they argued would require a change of culture within the bank.

Large foreign banks with a limited knowledge of local markets, may, for instance prefer to grant credit on a transaction by transaction basis using standardized decision rules when assessing creditworthiness. This may especially be the case if the foreign head office is chartered in a country with significantly different culture and serving multinational corporations from their home country, Sabi (1988). Contrary smaller domestic banks, with more knowledge of the local business sector will base their credit decisions on idiosyncratic and sort information and will build up client relationships, Berger and Udell (1995 – 2002).

Some studies confirm the hypothesis that banks lend less to informationally opaque SMEs. In the USA large banks tend to supply less to small firms Berger and Udell, (1995), Berger and Udell (2002) Goldberg and White (1999). They found that large foreign –owned banks have more difficulties in lending to small firms, although this result only holds for foreign banks that are headquarter in a geographically distant nation.

2.5.4 Absence of adequate Information on SMEs

According to Berger and Frame (2005), many SMEs do not maintain proper books of

accounts or have weak financial statements making it difficult for formal financial institution to assess their credit worthiness. This difficult in obtaining information to determine the creditworthiness of potential SME clients and the perceived risk forces financial institutions to charge them higher rates of interest or refrain from lending to them.

Banks evaluate the risk of borrowers from information obtained about them. The information generated over time through bank-borrower interaction should influence price and non-price terms of loans Fama (1985), Diamond (1984), Swank (1996), Thakur (1995), Neuberger (1998). It is probable that banks will charge higher loan rates on firms with less signalling ability because information asymmetry increases previewed risk. Firm characteristics e.g. size, age, management, and corporate type of status, can determine the degree of information asymmetry,

Despite all risks related to SMEs financing, banks can no longer ignore this sector if they want to gain a comfortable share of the credit market. In this respect financial institutions have proceeded to develop new credit tools specially conceived to meet the financial needs of this segment. However, even these new products present their own associated risks – generated by the peculiarities they present, which finally add to the final risk banks accept to take when financing SMEs, Nduba (2010).

Frame et al (2001) quoting Nakamura (1993) state that theories concerning SMEs credit markets has emphasized the existence of significant information asymmetries between borrowers and lenders. Such market imperfections result in credit rationing by lenders particularly when loans are unsecured. To mitigate such problems borrowers and lenders have historically used long-term relationships and continuous interactions that generate useful information about the borrower's financial state.

In recent years many banks have adopted automated underwriting systems based on credit scoring, Frame (2001). Credit scoring is the process of assigning a single quantitative measure, or score to a potential borrower representing an estimate of the borrowers' future loan performance, Feildman (1997). While credit scores have been used for some time in the underwriting of consumer loans, this technology has only recently been applied to commercial creditors. Specifically credit analysts have determined that the personal credit

history of small-business owners is highly predictive of the loan repayment prospects of the business.

2.5.5 Weak savings mobilizations and lack of capital.

In most of the developing economics there is an apparent lack of public confidence in the banking sector and in the national currency. In Kenya the ratio of the bankable to unbankable is 40:60. Thus the unbankable hold their money and valuables at home instead of depositing in the banks. A recent survey by CBK, verifies that more than Kshs. 3 billion in coinage form are in the informal sector in campaign "dubbed coin week." This reveals that many Kenyans prefer using other means of storing and settling their debt other than banking. This has resulted in the banking sectors small deposit base which is very short-term. This in turn limits the bank's ability to extend medium to long-term loans to borrowers including SMEs, CBK survey (2011)

2.5.6 Weak credit skills and practices.

Most big banks in developed and developing economics pursue large corporate loans as their main clientele. This is because large loans enable banks to grow their market size and profitability more rapidly. In contrast, SME loans are seen as less attractive because a bank would incur substantial amount of cost to process the loan, while the absolute dollar returns are much smaller compared to large corporation loans. It is in the recent that SME development and financing have come to the foreground. But loan officers have only been trained and equipped to manage and evaluate large borrowers with proper accounting records and information. Many lack the knowledge and necessary skills required to manage SME, which are more informational opaque. Applying the same techniques of large corporate evaluation to SME obviously result in many SME not being able to meet bank lending criteria, RAM consultancy services (2005)

Summary

According to Nduba (2010), in the current environment where banking is now characterized by cutthroat competition the challenge for any loan officer is to do a thorough

credit assessment of the customer to ensure safety of the loan and more importantly this assessment has to be done fast to avoid losing the deal to the competitor.

Small business enterprises have traditionally encountered problems when seeking finance from commercial banks to support their fixed capital investment as well as working capital for their operations. SMEs can rarely meet the conditions set by financial institutions which see most of them as a risk because of poor guarantees and lack of information about their ability to repay loans. Marvanga (2003), points out that challenges that faces SMEs in African and a developing country including Kenya is monumental. As noted many studies have dwelt on large firms and thus used the findings on SMEs which are totally different.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research design

The researcher employed a descriptive survey research design. Descriptive study portrays the variables by answering who, what and how questions. It is concerned with determining the frequency with which something occurs, or the relationship between variables. Thus it is the ideal approach as it will help detailed information through description which is useful for identifying variables and hypothetical constructs. It is important to use this kind of design because at a glance, you would be able to know what is the whole population based on the nature of data and the resources that was available.

3.2 Population

The target population in a research comprises all the potential participants that could make up a study group. The finding of this research was carried out on a population consisting of 15 bank officials dealing in SME financing from 11 commercial banks operating within Kisumu town to determine the Supply specific constraints. Census survey method was used for the in the determination of the respondents from the 27 commercial banks having operation within Kisumu town. All SME specialists from the 11 Commercial Banks were engaged because of them being fewer. These comprised the Business Development Managers, Business Customer advisors Credit Risk Assessors Business Loan assessors, Relationship Managers and Relationship Officers.

3.3 Data collection

The researcher used questionnaires for collection of primary data. This was consisting of both open and closed ended questions questionnaire that was administered through the drop and pick method. The questionnaires are designed with some questions requiring just making a choice from amongst the given options while others required short descriptive answers. The questionnaire method is appropriate as it enables the respondents to give related information.

3.4 Data Analysis

The data collected was thoroughly examined and checked for completeness and compressibility. Descriptive statistics was used to determine the various constraints face by SMEs in accessing credit from banks in Kisumu. This included the percentages, line charts bar charts and pie charts tabulations. Inferential statistics were computed with the help of the SPSS package to arrive at the conclusions based on the surveyed data collected. A five point likert scale was used to determine the importance of bank requirements for SME credit facility, financial statements used and the need of credit by SMEs. The likert scale reduces the level of subjectivity employed and enables the use of quantitative analysis.

4.0 DATA ANALYSIS PRESENTATION AND RESEARCH FINDINGS

4.1 Introduction

This chapter presents the analysis of the data collected and interpreted on the challenges commercial banks face in the process of financing small and medium enterprises. The objective of the study was to determine the constraints faced by commercial banks in financing SMEs within Kisumu town

My work is specific in scope and nature and is solely based on the review of information and analysis of data provided to me by the 15 respondents that participated in the review. I have relied on assurance provided by individual respondents as to the completeness and accuracy of the data and information provided to me. Furthermore I have relied on explanations given to me by individual banks without having sought to validate these with independent sources in all cases.

Data was collected from 11 commercial banks offering SME services within Kisumu town. The questionnaires were self administered and data was collected from Business Development Managers (B.D.M), Business Customer Advisors (B.C.A), Credit Risk Assessors (C.R.A), Business Loan Assessors (B.L.A), Relationship Managers and Relationship Officers.

Table 4.1 overview of data collected

Officers given questionnaires	Administered questionnaires (t)	Response rate (r)
B.D.M	4	3
B.C.A	2	2
C.R.A	4	4
B.L.A	3	1
S.M.E Relationship Managers	4	3
S.M.E Relationship Officers	2	2
TOTAL	19	15

Source: Research Data

Out of the 19 questionnaires that were circulated, 15 were dully filled and returned by the respective bank officers.

This represents a response rate of 79% which is considered significant to provide a basis for valid and reliable conclusions with regard to challenges banks face in financing SMEs

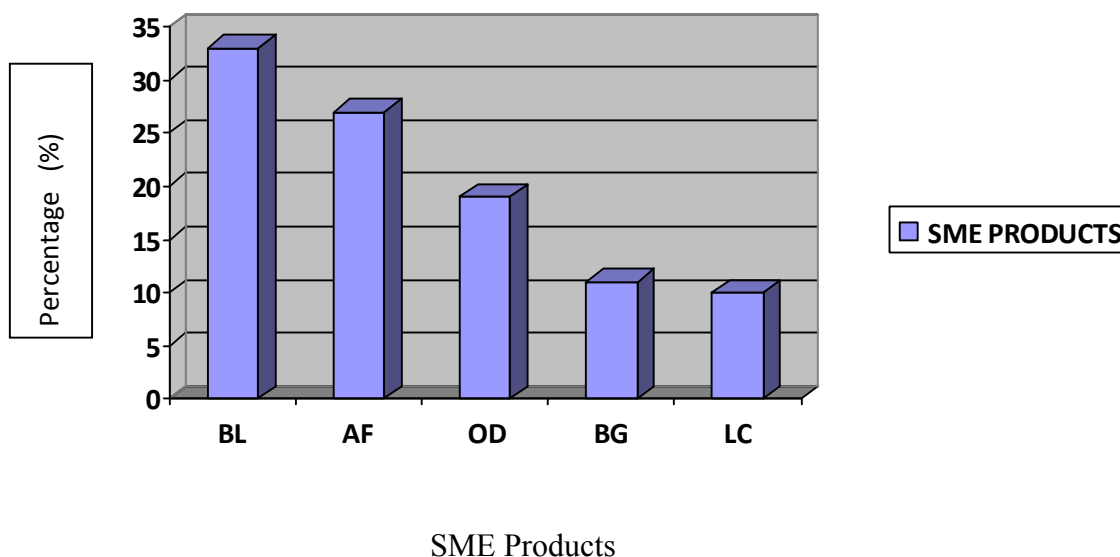
4.2 SME products offered by commercial banks

Table 4.2 SME products offered by commercial banks and their order of preference

Product	Order of rank	Preference by customers
Business loan	1	33
Asset finance	2	27
Overdrafts	3	19
Bank guarantees	4	11
Letter or credit	5	10
No of responses		100
Percentage (%)		

Source: research data

Figure 4.1 Products offered by commercial banks



Where,

BL- Business Loan

AF- Asset Finance

OD- Overdraft

BG- Bank Guarantees

LC- Letter of Credit

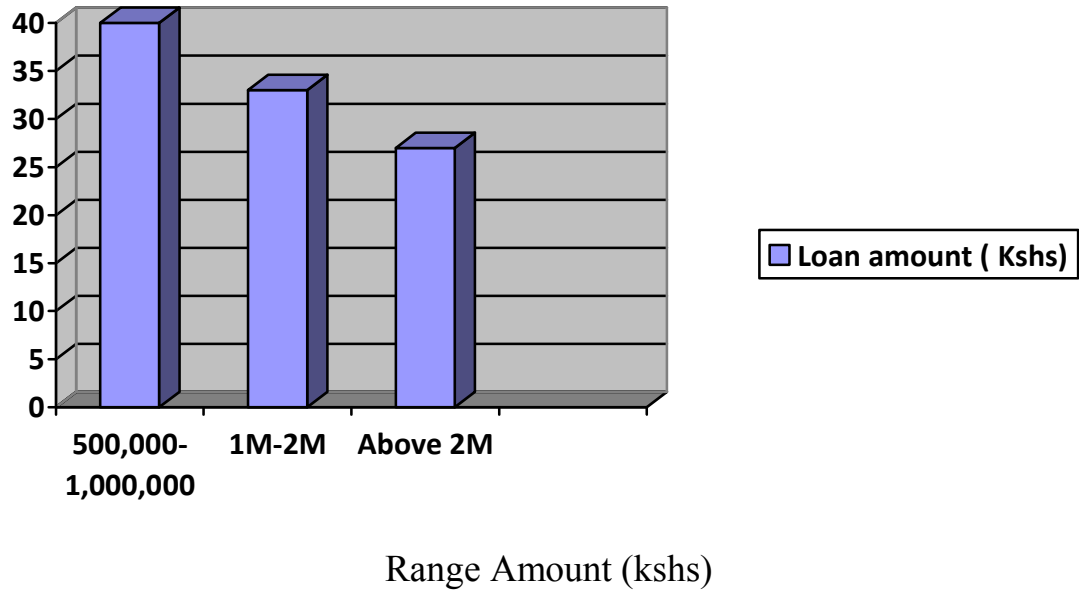
The most common SME product offered by commercial banks are business loan 33% Asset finance 27% overdrafts 19%, bank guarantees 11% and letter of credit 10%. Bank do offer other products to SMEs that are unique to individuals that this study did not consider relevant to research on.

Table 4.3 Loan amount frequently sought by SME customers.

Range of amount Kshs.	No of responses (r)	Percentage%
500,000-1,000,000	6	40
1,000,000-2,000,000	5	33
More than 2,000,000	4	27
Total	15	100

Source: Research Data

Figure 4.2 Loan amount applied most by SMEs



Research data reveals that 40% of the SME customer applied for amounts ranging between Kshs. 500,000 and 1,000,000. 33% applied for amounts ranging between 1,000,000 and 2,000,000 and 27% sought amounts above 2,000,000. However most of the respondents could not give the total SME loan book value to date sighting confidentiality of the matter.

4.3. Challenges faced by commercial banks in financing SMEs

4.3.1. Securities required for lending to SMEs.

The study sought to know the extent to which the respondents request for security.

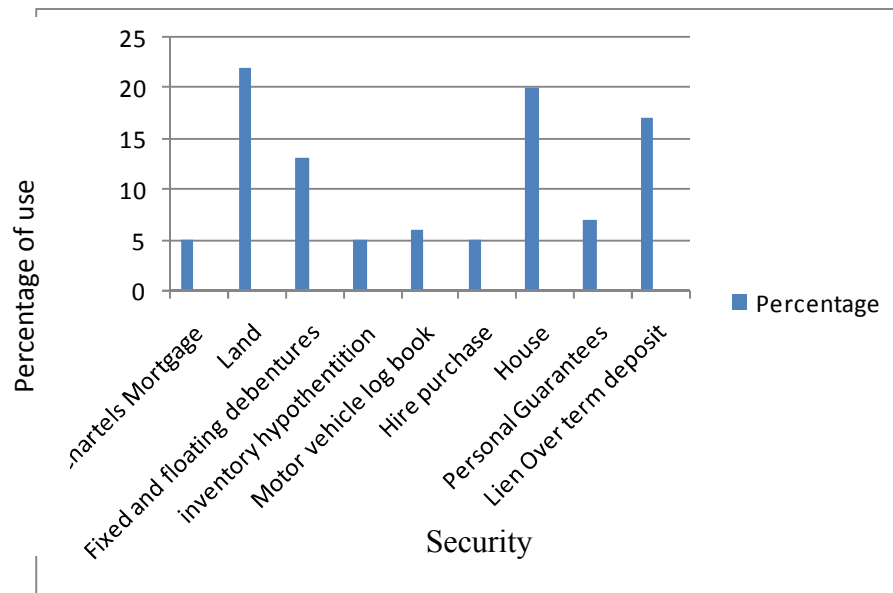
From the findings securities are required for in most cases where the SMEs owners cannot prove their credit worthiness. Commercial banks request collateral for loan facilities which most SMEs do not provide. This proves a challenge to most commercial banks in the process of financing this sector.

Table 4.4. Security required for lending

Security	No of responses	Percentage (%)
Chattels mortgage	3	5
Land	14	22
Fixed and floating debentures	9	13
Inventory hypothecation	3	5
Motor vehicle logbooks	4	6
Hire purchase	3	5
House	13	20
Personal guarantees	5	7
Loan over term deposits	11	17
Total	65	100

Source: research data

Figure 4.3 security mostly required in the lending process



Source: Research Data

From the above data analysis, it can be concluded that commercial banks mostly require land and houses as security at 22% and 20% respectively. Most commercial banks request for immovable assets as security that most SMEs lack or have not perfected in their own names.

Movable assets are not easily acceptable because of their faster in value deterioration and their easy of mobility.

4.3.2 What commercial banks requires before lending to SMEs

The research sought to know what bank need prior to lending to SMEs, the elements in the financial reports themselves. It was revealed that the business must have been in existing for the last one year, financial statements including current bank statement of at least 6 months, current management accounts and a trading license.

Table 4.5 documents required by commercial banks for lending to SMEs

Documents	No of respondents	Percentage (%)
Certificate of registration	15	100
Pin certificate	14	93
Tax compliance certificate	12	80
Cash flow projections	15	100
Balance sheet	14	93
Income statement	15	100
Bank statement	15	100
Management accounts	14	93
Memorandum& Articles of association	10	67

Source: Research data

From the research analysis, SMEs are required by all commercial banks to provide certificate of registration (trading license), cash flow projections, income statement and banking statements at 100% respondents 93% of the respondents requires PIN certificate balance sheet and management accounts. 80% request for tax compliance and 67% request for memorandum and articles of association. The two are low because most SMEs are

either operates as family business, sole trader or partnerships that are informal. They are not incorporated as companies.

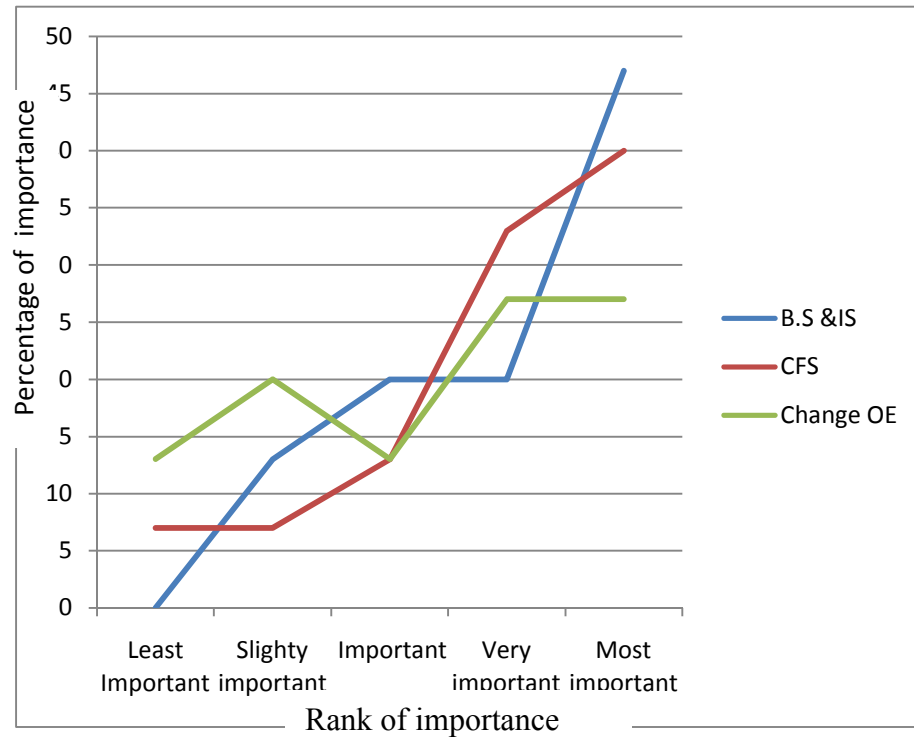
Table 4.6 Financial statements importance in the SME lending

	Least important		Slightly important		Important		Very important		Most important	
Balance sheet	0	0	2	13%	3	20%	3	20%	7	47%
Income & expenditure	0	0	2	13%	3	20%	3	20%	7	47%
Cashflow statement	1	7%	1	7%	2	13%	5	33%	6	40%
Change in owners equity	2	13%	3	20%	2	13%	4	27%	4	27%

Resource: research data

From the above analysis it will be noted that both the balance sheet and income and expenditure statement are ranked as very important statements required by commercial banks in lending to SMEs. This is because the two statements are vital in deriving the liquidity and profitability ratios that are vital in determining the viability of a business. Cash flow statement is ranked very important because it shows the ability of the firm to repay its debts as they fall due. Change in owners' equity is ranked not very important because most SMEs are not incorporated nor traded at the N.S.E

Figure 4.4 Ranking of the financial statements importance to commercial banks



Source: Research Data

Where;

B.S – balance sheet

I.S – Income and expenditure statement

C.F.S – cash flow statement

Change OE – change in owners' equity

Table 4.7 financial ratios importance in the credit analysis

	Least important		Slightly important		important		Very important		Most important	
Activity ratio	0	0	0	0	5	33%	5	34%	5	33%
Profitability ratios	0	0	0	0	1	7%	4	27%	10	66%
Debt ratios	0	0	0	0	0	0	3	20%	12	80%
Service ratios	0	0	0	0	0	0	2	13%	13	87%
BREAK EVEN	1	7%	1	7%	3	20%	4	26%	6	40%

Source: Research data

From the above data, analysis debt service ratio is ranked the most important at 87% followed by debt ratios at 80% and profitability ratios 66%. Both break even and activity ratios rank important with the break even ranked on all point scale and all below 40%. Ratio analysis is very important as it gives a clear business performance thus is used as the gauge of financial lending to the SMEs

4.3.3 Cost incurred in SME financing

The research sought to know the various cost incurred by SMEs in loans advanced to them.

From the research analysis, it was revealed that 80% of the commercial banks charge interest variably and 20% have a constant rate on amount sought.

Those whose interest varies depends on whether the customer had provided security or not. For non-secured it is the base rate + 2% whereas for non-secured it is the base rate + 4% other noted variable factors were membership to the various business club that have different name in different banks. Members of this club pay at 1% less the above rates. Only 13% of the respondent said the rate is based on amount sought. Those who apply for Kshs.10 million and below pay the base rate +4% while Kshs.10 million and above pay the base rate +2%

Other incidental cost incurred by SMEs in accessing loans from commercial banks according to the research analysis are negotiation fee, security perfection fee, stock insurance, life cover. Most of these costs are incurred before the loan is disbursed to the client.

80% of the correspondent said the processing for unsecured loan takes less than 48 hours to draw down. 8% said it takes two weeks, 8% said 4 working days and 4% takes one month. Secured loans take between 4-8 weeks to draw down. This delay is caused by the process of security perfection and charging security which is outside the banks control.

4.3.4. Sources of funds for financing SMEs

The research sought to know the various sources of funds used to finance SME by commercial banks. 80% of the respondents said the sole source for financing SMEs was customer deposits and interest charged on previous loans. 20% said beside the customers deposit and interest on loan, they have development partners who finance SMEs through their banks system. These include USAID, the government of Kenya and FMO of Netherlands. However, these funds are restricted to sectors of the provider’s choice and mostly are those most banks consider too risky to lend.

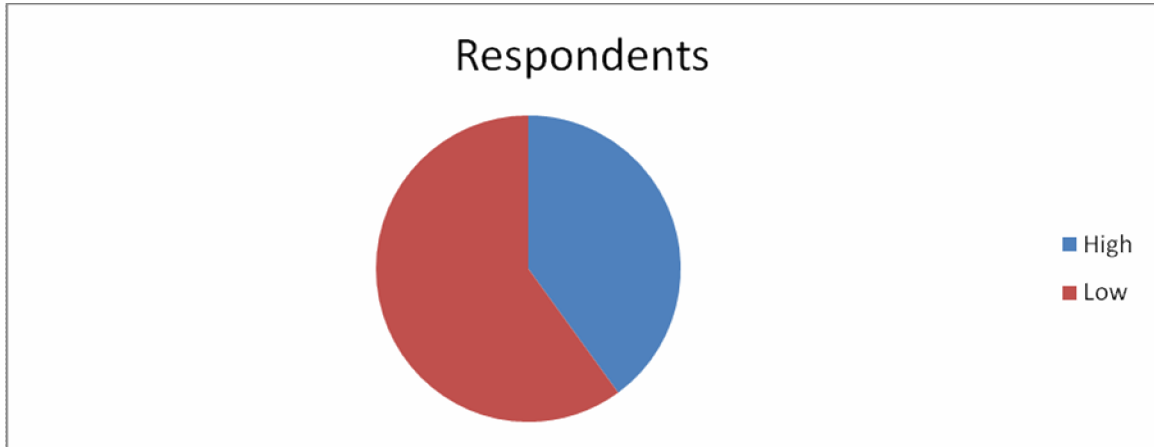
4.3.5 Rate of default on SME loans

Table 4.8 Non –performing portfolio

Default rate	No of responses (r)	Percentage%
High	0	0
Medium	6	40
Low	9	60
Total	15	100

Source: Research Data

Figure 4.5 default rate on loan repayment



Source: research data

60% of the respondents say the default rate is low while 40% says it is medium. Non of the respondent rated the default rate as high. This is because of the cautious risk management and credit scores method approach when lending to this sector. Only 13% of respondents said the size of the no-performing loan from the SME sector was Kshs 20m and below. The 87% could not give their figure sighting the confidentiality of the information matter

CHAPTER5: SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Commercial banks faces a number of challenges in financing SMEs in most developing countries, Kenya included. This study sought to establish these challenges and give a recommendation on how this could be turned into opportunities both for the SMEs and the commercial banks. The research findings have been analyzed and summarized in chapter four and indicates that most of these challenges could be addressed.

The study was a census survey where the response rate was good and representative with 79 per cent of the targeted population responding. 80% of the respondents said they do have an SME section established more than 2 years ago.

The study reveals that majority of the SMEs are unable to prove their credit worthiness to commercial banks to rely on. They lack banking history, financial statements (balance sheet, income & expenditure and cash flow statement). More so, banks also request for immovable assets to be pledged as collateral.

The research shows that most of the SMEs at 40 % request for amount ranging between Kshs. 500k and Kshs.1 million while 33% requested for amounts ranging Kshs. 1m and Kshs. 2 million and 27%, request for values above Kshs. 2 million. It was also revealed that the most applied product was business loan rated by 14 of the respondent as highly preferred. 11 respondents rated overdraft as the second preferred product followed by asset finance with 10 respondents and trade finance at 8. LPO were rated as medium preferred by 9 respondents. This shows that commercial banks could improved their lending book by focusing on business loans. Although overdrafts were ranked highly as preferences they are the most expense of the product sought. Thus, they are only applied as the last option. Secondly they are mostly short term and the approval rate is lower compared to their number of application. Trade finance is the latest innovation in the business market and therefore should be exploited fully to reap maximum benefit. However, caution should be taken as its risks are not yet highly known. From the findings it was also revealed that most commercial banks have customized their products to various segment e.g. business club, Biahsara club, asset finance focusing on specific individual and more so personalized services (relationship managers). However, despite all these innovative products, commercial banks have not yet fully known the need of SMEs and how to approach and satisfy these needs.

It was noted that financial ratios play a great role in the SME financial .87% of the respondents said debt service ratio is highly used followed by 80% of those who said debt ratio. These two ratios show the credit ability of the borrower and the commitment he has to date. Profitability ratio, break even and activity ratio were rated averagely at 66%, 40% and 33% respectively. Ratio analysis is important because it shows the borrower's ability to

meet his obligations when they fall due. Most SMEs have many sources of funds and therefore commercial banks strive in knowing their debt background. Most SMEs loans are declined because they already have more debts and are unable to borrow additionally.

The research results noted that 100% of commercial banks request for certificate of registration (trading license) cash flow projection, income statement and bank statement. 93% of the respondents request for the PIN certificate, balance sheet and management accounts. Tax compliance certificate and memorandum and articles of association are the least request at 80% and 67% respectively. Incidentally as commercial banks, request for this documents, the SME owners either lack them or do not have the manpower to prepare and keep proper records of accounts (books of account). This is an uphill task that commercial banks face in the process of lending to SMEs. SMEs are unable to provide vital information most banks need.

Land and houses were the most request security by commercial banks at 22% and 20% of respondents rating. This was followed by lien over term deposit, 17%, fixed and floating debenture at 13%. Personal guarantees motor vehicle log book at 7%, 6%, 5% and 5% respectively. Fixed assets are the most requested assets as security because they tend not to depreciate or deteriorate in value faster compared to movable asset. However, most SMEs do not own land and houses in their own names, making it very challenging for banks to lend to them. Security perfection was also noted as a challenge most commercial bank faces. The time taken to charge an asset pledge as security is relatively between 4 – 12 weeks and the expenses incurred also add up to the total expense of the borrower.

The research noted that banks charge various costs beside the interest on the principal amount. This is an additional expense that is borne by borrower even before the loan is approved. The banks also charge interest rates variably. This depends on the type of security provided, membership to various clubs and the amount sought. The variance was between 2- 4%. It was also noted that most of the commercial banks at the time of data collection were increasing their interest rate (base rate). This followed the increase by CBK to its lending rate from 7.5% to 11%.

The research has also revealed that only 20% of the commercial banks have external sources of funds and loans guarantee schemes to aide them in financing. These development agencies include among others the USAID agency, FMO of Netherlands and the government of Kenya.

5.2 Policy recommendation

The Kenyan market is currently anticipating improvement in information sharing with the implementation of credit reference bureaus. This will over time reduce major information asymmetries that exist in the market today. However banks must respond with an internal credit scoring system so that they may be able to maximize out the gains from credit

reference bureaus. In line with open communication between banks, individual banks must come up with guidelines and policies that will enable them to work statistical models to improve the credit granting decision proceeded for SMEs.

5.3 Credit product recommendation

My research and analysis would suggest that there are no material difference between the product offered to SMEs by Kenyan banks and other countries. More importantly it will appear that the main concern of SMEs is not the range of products on offer but rather access to credit facilities, particularly working capital facilities. I recommend that the measures which would support access to credit for SMEs from sustainable innovative business propositions can be grouped around the following themes:

1. Consider the need for risk sharing structure in light of the facts established below:-
 - a). Measures to support the easing of the working capital requirement of SMEs.
Models that are worthy of specific consideration are
 - Credit guarantees schemes
 - Credit insurance support
 - Prompt payment support
 - b) Measures aimed at helping SMEs to maintain investment levels and achieve long term sustainability in the future. Consider the following models
 - Private equity financing stimulation model
 - State sponsored investment model
2. Consider a series of initiatives to develop the relationship and understanding between banks and SME with the objective of improving access to credit

5.3 Limitation of the study

Local information on challenges commercial banks face in financing SMESs is scarce as this subject has not been explored by many local scholars and researchers. The information used to compile this study was mostly based on research from foreign sources who have explored this subject area in greater detail only a few unpublished University of Nairobi project featured on the topic of challenge facing SME financing /credit access from commercial banks.

The study was based on commercial banks operating SME within Kisumu town. It was noted that 11 commercial banks offers SME services. Thus a different could be yield if the study was to be carried out on all commercial banks offering SME financing country wide. Due to financial constraint and short time, a more comprehensive survey could not be carried out which could have obtained a more representative results to this study.

The researcher could not get all the information requested in the questionnaire with the questions requesting data on SME lending book to date and the amount of SME default being avoided by 80% of the respondents.

5.4 Suggestions for further studies

The ultimate objective of this study was to determine the constraints commercial banks face in SME financing within Kisumu town. Thus a more coverage area to include the whole commercial banks could be done that would improve the viability of the result that will be most representative.

A future study could be done on the challenges faced by SMEs (demand) in getting finance from commercial banks in Kenya.

A more comprehensive study could be carried out to outline how banks are addressing the challenges they face in financing SMEs.

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LIST OF COMMERCIAL BANKS OPERATING IN KISUMU TOWN

1. Bank of Baroda
2. Barclays Bank of Kenya
3. CFC Stanbic
4. Chase Bank
5. Commercial Bank of Africa Limited
6. Commercial Bank of Africa
7. Diamond Trust Bank
8. Co-operative Bank of Kenya
9. ECO Bank
10. Family Bank
11. First Community Bank
12. Credit Bank
13. Giro Bank
14. Guardian Bank
15. Habib Bank
16. HCFCI
17. I & M Bank
18. Kenya Commercial Bank
20. National Bank of Kenya
21. NIC Bank
22. Standard Chartered Bank
23. African Banking Corporation
25. Equatorial Commercial Bank
24. Equity Bank
26. Bank of Africa

Appendix: QUESTIONNAIRE

CHALLENGES COMMERCIAL BANKS FACES IN SME FINANCING.

1. What is the name of your Bank?

2. When did the bank start offering SME banking products & services to customers?

3. What are the major banking products and services offered by the bank to the SMEs (**name as many as possible**)?

4. What is the loan amount frequently applied for by SME clients (tick only one)?

1 500,000 – 1m

2 More than 1m

3 2m and above

5. What is the size of the SME lending book to date? (**Kshs**) _____

6. To what extent are the following challenges faced by Commercial Banks in lending to the SMEs? (**1- least faced; 5 - mostly faced**)

	1	2	3	4	5
a) Lack of security	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
b) Lack of Audited financial	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
c) Registration certificates	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
d) Banking History	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

7. What are the key items looked for before lending is done to SMEs (**name as many as can**)

8. What are the key factors/characteristics looked at the credit appraisal stage?

9. Do SMEs submit the following documents while applying for the loan facility from commercial banks?

- Certificate of registration/incorporation
- PIN number
- Tax compliance certificates
- Memorandum & Articles of Association
- Cash flow projections
- Income statements
- Balance sheet
- Management accounts
- Bank statements for atleast 2 years

10. How important are the following ratios in the balance sheet statement to credit analysis process? **(1-least; 5-most important)**

	1	2	3	4	5
Activity ratios	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Profitability ratios	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Debt ratios	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Debt service ratios	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Break even as a% of sales	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

11. Among the following financial statements, kindly rank them in order of their superiority. **(1-least important; 5- most important)**

	1	2	3	4	5
Balance sheet	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Income statement/Income & Expenditure	()	()	()	()	()
Cash flow statement	()	()	()	()	()
Changes in owner's Equity	()	()	()	()	()

12. Do you always require security for the loan applied for by SMEs?

Yes _____

No _____

13. If yes, what type of security is more often asked for by the bank?

- 1 Chattels mortgage ()
- 2 Land ()
- 3 House ()
- 4 Personal guarantees ()
- 5 Lien over term deposits ()
- 6 Fixed & floating debenture ()
- 7 Inventory hypothecation ()
- 8 Motor vehicle log books ()
- 9 Hire purchase agreements ()
- 10 Any other (**please specify**) _____

14. Is your lending **cash flow** based? Yes _____ No _____ --

15. What are your sources of funds for financing SMEs?

16. Kindly enumerate the amount of money which has been lent by each source

- **Kshs** _____
- **Kshs** _____

17. Do you have loan guarantee schemes for your SME customers?

Yes _____ No _____

18. If yes, what are the amount guaranteed and the source?

Amount (Kshs) _____ Source _____

19. Is the interest Rates charged to the customers' variable? Yes _____ No _____

20. If yes, kindly state interest rates (%) pegged on the following range of amount of loans.

1 500,000 and below _____

2 >500,000 – 1m _____

3 More than 1m _____

4 More than 10m _____

5 Any other (Specify) _____

21. State any other costs incurred by the clients' in the process of obtaining the financing

22. What is the Turn-Around-Time for the loan application?

23. What is the rate of default in the loan repayment by the SME clients (**tick one only**)?

1 High _____

2 Medium _____

3 Low _____

24. What is the size of the non –performing loan from the SME customers?

20m and below _____

20m – 30m _____

30m – 50m _____

50m – 100m _____

100m and above _____