

**THE RELATIONSHIP BETWEEN LEVEL OF CREDIT AND GROWTH OF  
MICRO AND SMALL ENTERPRISES (MSEs) IN NAIROBI**

**By**

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**D61/P/7875/2000**

A Management Research Project Submitted in Partial Fulfilment of the Requirements for  
the Master of Business Administration Degree of the University of Nairobi

**UNIVERSITY OF NAIROBI**

**SEPTEMBER 2011**

## DECLARATION

I declare that this project is my original work and has not been submitted in any other university.

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## **DEDICATION**

This research project is dedicated to my parents for their unwavering support financially, materially and in prayers.

## **ACKNOWLEDGEMENTS**

There are many people who have invested their lives and time, to make it possible for the development of this project. The price a family pays when writing a project is high. I therefore express my gratitude and indebtedness to my family for their unconditional support throughout my study. My thanks go to wife and children without them I would not have been able to do much.

My gratitude again goes to my supervisors; Mrs. Angela Kithinji who patiently and tirelessly guided me in the production of this project. Thank you so much for your constant concern and encouragement in the task of writing this project even when the going proved daunting.

## **ABSTRACT**

SMEs are generally undercapitalised, suggesting major operational difficulties in accessing credit and pursuing corporate goals. The Baseline Survey (2000) showed that only six percent of SMEs successfully applied for and used credit. It is unclear how the rest who form the majority, meet their working capital and investment needs. Enterprises that successfully sought out credit received very modest amounts, probably reflecting the level of activities in which the enterprises are involved (Kimuyu & Omiti, 2000). The extent to which entrepreneurs in Kenya can actually benefit from the utilization of this potential and the factors that influence the adoption of this potential has been unclear. As such, the main purpose of this study was to assess the relationship of credit on growth of micro and small enterprises (MSEs) in Nairobi.

Both qualitative and quantitative methods were used for data analysis. Quantitative methods of data analysis such as use of percentages and frequencies were employed in this research. Information was presented in the form of tables and Pie Charts. Growth to be analyzed for the purpose of this study was limited to a period of time that is from 1990 to date. The analysis focused on the changes in following variables: - assets in an enterprise, turnover, investments, outlets and branches. These variables were used to establish generalizations or facts in achieving the objective of the study, which was to determine the impact of credit financing on the growth of the SMEs sector in Kenya.

From the study findings most of the businesses were getting credit from financial institutions as banks have been presented as a reliable source of finance for most businesses. Further the study found micro finance institutions to have been readily available and to have high level of credit. From the study findings most of the businesses were being financed by micro finance institutions as compared to other commercial banks.

The study in its recommendations noted the need for borrowers to be educated on credit usage and how to make repayments so as to maintain their creditworthiness. The micro finance should adopt a reducing balance mode of repayment in order to attract more borrowers. For the vision 2030 to become a reality and poverty eradication to achieve its goals, credit has to be made available to finance the required areas of investment.

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## **LIST OF ABBREVIATIONS**

- CIDA** : Canadian International Development Agency
- DFIs** : Development Finance Institutions
- FKE** : Federation of Kenya Employers
- ILO** : International Labor Organization
- GOK** : Government of Kenya
- GTZ** : German Technical Cooperation
- IYB** : Improve Your Business Kenya
- JBLS** : Joint Loans Board Scheme
- KIM** : Kenya Institute of Management
- K-MAP**: Kenya Management Assistance Program
- K-REP**: Kenya Rural Enterprise Program
- KWFT**: Kenya Women Finance Trust
- LDCs** : Less Developed Countries
- SMEs** : Small and Micro Enterprises
- NCCK**: National Council of Churches of Kenya
- NGOs** : Non-Governmental Organizations
- OECD**: Organization for Economic Co-operation and Development
- PfP/K** : Partnership in Productivity Kenya
- PRIDE**: Promotion of Rural Initiatives and Development Enterprises Ltd
- SAPs** : Structural Adjustment Programs
- SED** : Small Enterprise Development
- USAID**: Untied States International Development

# **CHAPTER ONE**

## **1.0 INTRODUCTION**

### **1.1 BACKGROUND**

Glaser and Maalu (1999) assert that the first problem to overcome in any study of Small scale enterprises is that of definition. The point under which an enterprise is deemed to be small and the way in which its size is measured is included in the definition of working concepts and has been a debatable subject for a long time and no general consensus has been reached. Ekpenyong (1992) studying about medium scale enterprises in Nigeria supports this view.

Credit in the context of this research can be defined as any financial assistance given to SMEs. Credit may be in cash or in kind given either to start up a business, increase enterprise working capital or investment in terms of assets. Sources of Credit include commercial banks, microfinance institutions, cooperatives, development financial institutions, government, nongovernmental organizations and rotating savings & credit schemes.

A number of studies conducted in Kenya, confirmed that a positive relationship exists between income and employment. Kinyanjui (1993) observed that self-financed firms generally started smaller than both the medium and fast growth firms that started with external financing and were characterized by a relatively high incidence of commercial bank start up financing.

ILO Report (2004) defines informal sector, which generally encompass most Small-scale enterprises as, "...very small scale units producing and distributing good and service and consisting largely of independent, self employed producers in urban areas of developing countries. They employ family labour or a few hired workers or apprentices which operate with very little capital or none at all utilizing low level of technology and skills which operate at low level of productivity." From the definition the following facts are clear about SMEs. They are unregistered; have little or no access to organized markets, credit institutions, many public amenities, formal education and training; and are not recognized, supported or regulated by government.

Empirical evidence suggests that women's MSEs tend to grow more slowly than those owned by men. One contributing factor to the slower growth of female-owned MSEs is that their firms have an especially high probability of being physically located within the household ILO, (2004).

Dondo (1993) argues that the study of SMEs has been prompted due to the fact that; this sector has high potential of creating employment and generates goods with low foreign exchange content. The author adds that SMEs can handle youth and women welfare since most drop outs end up in this sector and owing to the fact that they are Kenyan owned and operated thus enhancing the policy of kenyanization of the economy. They also emphasize on district focus for rural development projects leading to equitable development of all regions in Kenya and reduction of rural-urban migration which is a menace. SMEs are quite dynamic and thus create proper forum for industrialization.

The importance and potential of the informal sector cannot afford to be understated since supporting this sector by and large means supporting the poor in society which is an end in itself.

According to Ondiege (1995), the informal sector which has a majority of the poor participating as entrepreneurs, employers and customers plays an important role in production, distribution, finance and employment creation in African economies and needs therefore to be given serious consideration to help reform Africa's economic structure.

GOK (1986) outlines the broad goals of this sector as; provision of goods and services, rapid job creation to meet the needs of growing labour forces and indigenization of economy through development. Small enterprise and Juakali development are thus a developing foundation for local entrepreneurship and stimulation of national development.

SMEs have been supported by developed countries because of increased focus of development support programmes especially because of employment creation potential of this sector (House, 1978). Baseline Survey by K-rep (1999) reveals that over 1,300,000 Small Micro Enterprises had employed over 2,400,000 people and over 300,000 jobs are created annually. Despite this they face unique problems affecting their survival and profitability, thus decrease their ability to contribute to sustainable development.

Small enterprises have gained prestige in the recent years, but an analysis of their problems and potential contribution still suffers from a tendency to treat them qualitatively different from larger industrial firms. As a result the problems they have with other firms in their industry may be ignored or their source erroneously attributed to their small size. Lack of industry specific information on small establishments also makes it difficult to appreciate the range of technology and plant organization within given industries (McCormick & Pedersen, 1996).

Johnson (1990) reports that massive public-sector support as first designed in India (the so called SMDAs) has proved rather cost ineffective; such support has often provided a large number of inadequate services free of charge to a limited number of small firms. Many such programs have become prime candidates for curtailment under the remorseless axe of SAPs. Thus the approach taken by governments in most developing countries has been primarily interventionist. This approach has not been particularly successful, in its direct support programs, in credit extension services and has been generally disappointing since little development has been achieved at high costs in terms of resources.

## **1.2 STATEMENT OF THE PROBLEM**

SMEs are generally undercapitalised, suggesting major operational difficulties in accessing credit and pursuing corporate goals. The Baseline Survey (2000) showed that only six percent of SMEs successfully applied for and used credit. It is unclear how the rest who form the majority, meet their working capital and investment needs. Enterprises

that successfully sought out credit received very modest amounts, probably reflecting the level of activities in which the enterprises are involved (Kimuyu and Omiti, 2000)

Dondo et al (1986) observe that experience shows that the informal sector enterprises generally have no access to credit facilities from formal institutions and where credit is available within the informal sector the resources interest rates are high. Informal sector enterprises find the banks unhelpful and unsympathetic to their needs, since unlike their formal sector counterparts, they cannot provide the necessary collateral. Most enterprises therefore have to rely mainly on their own savings which given, their level of incomes are naturally low.

Szab'o (1997) observes that SMEs have great difficulty obtaining funds compared to large enterprises. He cites that, as a general rule banks have no real experience and expertise in dealing with this sector. Smaller companies are perceived as being more risky and investors either refuse to invest or expect a higher rate of return on their investment, which the borrower must be able to pay. He also observes that in most countries there is overwhelming demand for medium and long-term credit, in particular for starting up Small Enterprises. At the same time entrepreneurs have too little collateral, which he identifies as a main constraint on the growth of SMEs. The author also observes that in almost all countries governments have implemented a wide spectrum of programs promoting SMEs. They generally consider finance as the major component of promotion policies for development and growth of enterprises especially SMEs.

A report by FKE (1993) postulate that various studies carried out show that most small enterprises in Kenya die between 1 and 5 years as opposed to Western countries where the death gap is between 5 and 10 years or more. They also established that SMEs operate in complex and constraining environments, which are inhibitive to their growth. These include an unconducive enabling environment; lack of access to physical infrastructure (inaccessibility of electricity, inadequate and lack of access to industrial plots, lack of water, telephone, sewage and well maintained roads) and administrative infrastructure (inhibitive laws and regulations, finance, markets, non-financial promotional programs and technology).

Geest and Hoeven (1991) pointed out that inadequate product and consumer markets, limited access to credit, poor management skills, poor market organization as well as harassment by officials are to a large extent the factors responsible for the high enterprise mortality.

This study therefore sought to establish whether traders who applied for and used credit to finance their business experienced growth in terms of increased savings, investments, working capital, fixed assets and net income.

### **1.3 RESEARCH QUESTIONS**

Answers were sought for the following research questions:

1. What are the SMEs entrepreneurship attitudes towards credit?
2. What are the institutional impediments to access to credit by SMEs?

3. What is the extent of credit usage?
4. What is the relationship between credit financing and growth of SMEs?

#### **1.4 OBJECTIVES OF THE STUDY**

The objectives of this study were:-

1. To determine the SMEs entrepreneurship attitude towards credit.
2. To establish the institutional impediments to access to credit.
3. To determine the extent of credit usage by SMEs.
4. To establish the relationship between credit financing and growth of SMEs.

#### **1.5 JUSTIFICATION OF THE STUDY**

There is widespread agreement that the SMEs sector embraces a vast majority of the target groups. The problems they face are current and very timely and thus the need for viable policies to be adopted by both private and public institutions cannot be overlooked if this sector is to become Kenya's "industrial power house".

The importance of the informal sector extends beyond employment; it provides a "point of entry" for many Kenyan entrepreneurs into the manufacturing and service sectors and acts as a "testing ground" for the development of low cost products. The need of knowledge of the barriers that exist and that hinder SMEs growth will be of use to policy makers and planners in Kenya, in developing policy interventions and strategies that are viable in enhancing the expansion and growth of SMEs.

The problems faced by SMEs relate to a large population of the people in that, the sector is geographically and well distributed throughout Kenya in both rural and urban areas. Part of the rationale of this study will help in design of policies that can create a climate for economic opportunity for entrepreneurs and in generating useful program and policy information that the institutional actors may rely on in their decision making in giving credit to business enterprises. The study helped modify existing program designs or in selecting the most effective strategies among several alternatives to work with these enterprises in the light of evidence that will be generated.

In addition to this it will also help in filling the gap in knowledge on SMEs by documenting problems of SMEs, especially financial which deter their growth. Information provided would assist the key institutional actors in improving the business climate for SMEs.

## **CHAPTER TWO**

### **2.0 LITERATURE REVIEW**

#### **2.1 HISTORY OF SMALL AND MICRO ENTERPRISES (SMEs)**

Marries and Somerset (1971) report that Kenya has one of the longest histories in promoting SMEs in Africa. The first real effort at promoting small enterprise was in 1967, when the KIE was established. It was set up to provide credit, management assistance and industrial estates so as to encourage the formation of enterprises in urban and rural areas by Kenyan citizens of African origin.

Micro entrepreneurs have certain characteristics like age, education, gender and managerial ability, which affect their skills, knowledge and attitude Van Praag (2005). Oketch purport that the current favorable attitudes and policies towards the SMEs sector, both locally and worldwide owe much to the 1972 ILO mission in Kenya. The report of that mission highlighted the limitations of previous industrial development policies in Kenya (and by extension much of the developing world). It also identified characteristics of micro-enterprises that had relevance to the problems of rising unemployment and poverty. Above all the study developed the now popular concept of the "informal sector". The improvement of agency belief leads to better strategies like technology adoption, quality improvement, product innovation and market expansion (Nafziger 1977; Audretsch and Keilbach 2004; Van Praag 2005).

Ondiege and Dondo (1990) have a common view that the ILO report used the term informal sector to describe the portion of urban economy that escapes enumeration in

official statistics. It set in motion worldwide interest in the potential of the informal sector in promoting growth and income opportunities in the rapidly expanding cities of the LDCs where the characteristics of the sector were for the first time examined. They contend that the report highly cited the sector as a priority area for emphasis in the economic development of the country.

The initial response of the Kenyan government to the I LO report, as contained in the 1983-1988 Sessional paper on employment was by and large accommodating. Since then subsequent commitment to the expansion of the informal sector continues to be mentioned in all subsequent National development Plans, although the methods of carrying out this commitments are far short of what is required (Macharia, 1997).

McCormick and Pederson (1996) argue that for small enterprise support to be successful it must engage many partners in dialogue who command different resources and often have competing interests, without at least partial coordination of strategies. Therefore development in general and especially SED is unlikely to take-off.

## **2.2 ROLES OF SMEs IN THE ECONOMY**

The informal sector should be recognized for the many services it renders to the growth of African economies in the provision of income, training and millions of jobs to workers who would otherwise remain jobless and unskilled, and in the production of many intermediate and final products. In addition to the perceived economic benefits, MSE development has long been viewed by policymakers as a means to increase incomes of

the poor. MSE owners and workers do tend to be disproportionately poor, with the incidence of poverty within MSEs higher than in medium and large firms. However, current thinking on the part of international donors focuses less on the size of enterprises and more on outcomes, seeking patterns of economic growth that are beneficial to the poor, or “pro-poor.” Growth that is broad-based by both region and sector is more likely to be faster and provide greater opportunities for the poor. Similarly, rapid growth in regions where the poor live and sectors of the economy in which they work is likely to result in poverty reduction (OECD, 2004).

Evidence suggests that in most industrialized countries SMEs play significant roles in the industrialization process. In Japan, for example, 99% of all enterprises are in this category, employing over 80% of the total workforce. Kenya by contrast has few large enterprises and many micro-enterprises (mostly in the informal sector) but very few SMEs. These lower end enterprises contributed only 5% to the formal sector workforce (Gatheru and Shaw, 2000).

Kenya's economic record during the 1990's has remained far below its potential despite major economic reforms implemented. The declining performance of the domestic economy coupled with the ongoing public sector reforms has adversely affected growth in employment within the modern sector. The reform programs, which involve freezing in employment and natural attrition, with the view of rightsizing staff in the civil service sector and Teachers Service Commission (TSC.) in addition to the privatization of non-strategic public enterprises and reforming strategic public sectors have been attributed to

the steady decline in employment, with the decline being felt in all economic activities including the financial sector which recorded the highest decline of 47% (Economic Survey, 2000).

With these general observations in mind the Kenya Government has since realized and adopted various policy interventions to promote SMEs development. GOK (1992) provides the policy framework for promoting such enterprises.

Donor agencies and nongovernmental organizations as well have also had their impact felt in a bid to promote and support this sector which has in the recent past enjoyed a negative public image characterized by a myriad of problems that have hindered its rapid expansion and growth (Kenneth King, 1996).

Given the importance of such firms globally, it is crucial for Kenya to identify strategies to build up the sector if Kenya is to industrialize in the near future. Crucial to this success will be links between firms at all levels to promote growth and competitiveness.

### **2.3 SMEs AND POVERTY REDUCTION**

SMEs are an important means of creating sustainable wealth for poor communities in rural and urban areas in developing countries. Over the past decade many studies have described their merits, constraints and the various projects and programmes that have been used to promote and support this sector.

Better understanding of the impact that financial development can have on the access of firms of different size to external finance should help illuminate the important link between finance and poverty reduction. Prasad et al. (2005). According to the Organization for Economic Co-operation and Development (1993) a thriving micro-enterprise sector operating in an expanding economy will be a key factor in future development strategies. It can generate income and employment production; create linkages that support and deepen development progress in the rural sector, the large-scale enterprises and external sector.

Johnson (1990) observes that small enterprises in Kenya and in developing countries provide crucial linkages between; traditional and modern production systems, agriculture and industry, rural and urban areas as well as in production and consumption patterns. He also acknowledges how small enterprises diversify the local economy, produce relatively cheap products for consumption, supply regional and national markets, contribute to foreign exchange earnings and increase technical and management skills of the rural population.

The Organization for Economic Co-operation and Development (1993) holds that small enterprises are particularly important to low-income people, especially women who in many countries constitute the majority of micro-entrepreneurs. Women who often find themselves without access to jobs in the formal sector, due to either lack of training and/or the competing demands of households maintenance and childcare, yet they increasingly shoulder family financial burdens. Sustainable improvements in the

productivity of SMEs are therefore essential for the creation of new wealth and opportunities for the people involved.

## **2.4 SMEs AND EMPLOYMENT CREATION**

In the past, African economies have tended to ignore the informal or SMEs sector, however in recent years many countries have come to realize the importance of the sector in promoting income and employment promotion. For instance in Kenya research shows that outside agriculture and the public sector, employment opportunities in the informal or SMEs sector outweigh those in the formal wage sector industry and commerce (Dondo, 1995).

Szab'o (1997) observes that the promotion of widespread entrepreneurship through the setting up of small and medium-sized enterprises is crucial for the transformation to a market economy and democratization of society in many countries. SMEs are recognized as an engine of growth and a source of sustainable development. Within this sector SMEs are of special importance because they are considered as the cradle of entrepreneurship particularly in environments facing high unemployment and poverty. SMEs can create and provide income-generating opportunities to alleviate poverty.

The GOK (1992) estimated Kenya's dynamic informal sector as providing over half the total employment and having recorded an expansion of nearly 70% over the previous four years. As such the sector has performed a vital role in absorbing surplus labour.

This view is shared by Macharia (1997) who, though variably estimates about 75% of all new jobs as being in the informal economy (SMEs) with about 47% of the current jobs in Kenya being in the informal economy and at least 14,000 businesses registered as small enterprises. This goes a long way to show the inevitability of practically supporting SME development, which is one way of targeting the poor with a dynamic purpose to alleviate poverty.

## **2.5 FACTORS IMPACTING ON GROWTH OF SMEs**

Dondo (1993) identifies some key institutional actors and the roles they play in the growth of SMEs. These include; Government in offering credit and extension services and in its new role as a facilitator i.e. in improving the overall climate for investments and expansion of small enterprises, NGOs in increasing growth and sustainability of overall credit for SMEs, Commercial banks in lending and offering credit programs specifically for SMEs and DFIs in enterprise promotion.

The MSE sector is large and heterogeneous. Development policies and programs that include “small enterprise growth” among their explicit or implicit objectives may be targeting the majority of firms in a country. The insights from this study can help to formulate a more defined targeting strategy. Program designers and implementers should have a clearly developed causal model that shows how the intervention works to achieve small enterprise growth. Important to this is an understanding of how the intervention will influence firm opportunities, capabilities, and productivity. Simeon Nichter and Lara Goldmark, (2005)

Dondo (1993) points out that there are over 75 credit programs for small enterprises today implemented by the GOK, DFIs, Commercial banks and NGOs. The significant increase in the number of institutions supporting this sector has not been matched by the significant changes in policy although many policy pronouncements have been made. However significant operational changes have occurred among implementing institutions. For example during the 1980's new lending methodologies had been started and innovative strategies had been adopted for providing credit and non-credit assistance to the sector.

According to Mwarania (1993) there are over 1,000 NGOs operating in Kenya. Most of them he argues have strong links with foreign NGOs, which are usually their parent organization. They are extremely dependent on external donor support and most would not survive without it. Their operations tend to be area specific and very few have a nation-wide network. He observes that most NGOs begin as community welfare groups; although over the years many of them come to include provision of credit in their operations. They typically employ people with one or two dominant personalities (usually their founder members) and that despite this they control considerable budget sometimes running into millions of shillings. Ondiege and Dondo (1990:30) observe that this group of small enterprise lenders is the newest and potentially most interesting with respect to further growth and sustainability of institutionalized credit for SMEs.

There are private initiatives for the promotion of the Informal sector. Kenya Institute of Management provides programs for development of Managerial and Entrepreneurial skills while K-MAP maintains a list of experts who advice informal sector entrepreneurs

on one-to-one basis on specific business problems. They also hold that donor agencies also participate quite actively in this sector, such as USAID, Ford foundation and CIDA.

Mwarania (1993) emphasizes that NGO's run a whole range of credit schemes including revolving funds, seasonal credit schemes, loan guarantee schemes and individual credit schemes. The amounts advanced are usually small (rarely go beyond KShs.10,000). He contends that NGO's therefore are the main sources of extra-household funds used in micro-enterprise development. Some NGO's focuses on women entrepreneurs while others on both men and women.

Ondiege and Dondo (2003) report that experience reveals a mediocre performance of the participating NGO's despite their major efforts at institutional building, staff training and the provision of funds for lending to SMEs. Somewhat surprisingly, the first attempts they made were very similar on a more modest scale, to the "integrated approach" popular to the DFIs of the 1970's. The programme provided training to individual borrowers prior to their advancement of a loan and also provided them with post loan counseling. K-REP also supported their NGO borrowers with a great deal of institution building assistance related to staff development, loan monitoring system and conceptual planning. They also reveal that after several years of trying this approach and recording several levels of adjustments and recoveries averaging 78%, K-Rep decided to alter course and adapt the minimalist model developed in Asia by the Grameen Bank of Bangladesh. They are of the view K-Rep itself including all other major NGO's operating credit schemes in Kenya have adopted the minimalist approach. Although the

approach is still relatively new in Kenya, it does offer hope for lending small amounts in a cost effective manner to a large number of SMEs operators. Using this method the cost effectiveness of these programs has been improved to the extent that the ratio of credit disbursed is 0.25: 1.

The characteristics of credit determine what a micro entrepreneur can use the money for and whether it is going to be accessible to them. Fungibility is the quality of being capable of exchange or interchange, in other words a fungible credit will have the ability to be used either for consumption or production. A credit with huge paper work and heavy collateral may not be accessible to small business holders (Soyibo 1997; Audretsch, Keilbach, and Lehmann 2006) though the credit is fungible.

Ondiege and Dondo (1995) are of the view that despite the fact that some NGO's are still doing well, the long-term commitment of most of them to small enterprise lending is questionable. Many still have a local orientation and still find it difficult to harmonize a tough banking approach with their original goals of public welfare. The NGO's which were set up specifically for the purpose of lending to small enterprises such as K-Rep, PRIDE and the KWFT are less confused in their missions and offer some of the best prospects of sustainable programs for the sector.

## **2.6 HINDRANCES TO GROWTH OF SMEs**

A review of development assistance projects and programs targeted to the SMEs sector suggests that more efforts by governments, assisted by donor agencies, to support the

promotion and development of SMEs have so far concentrated on building up centralized institutions, which were intended to provide a range of support programs. In general these government-supported institutions adopted a supply side approach. Providing programs and services they believed SMEs needed (e.g. technological advice, training, credit programmes); they then waited for clients to come forward and avail themselves for support activities offered (Levitsky, 1993).

According to Macharia (1997) in the ten-year period between 1986-1996 the GOK had shown more interest in the promotion of SMEs as evidenced in its policy papers like the Sessional paper No.1 of 1986, the Sessional paper No. 2 of 1992 and the National Development Plan of 1989-1993. All these papers have emphasized on the importance of SMEs in the country's economy with a number of ministries being involved in implementing assistance programs for SED programs in the Ministry of Planning and National Development and the Ministry of Culture and Social-Services. He argues that despite the presence of policy papers mentioned and various ministries, there is lack of coordination of government policy that usually has been poorly implemented. The same small enterprises have suffered at the hands of the government security officers.

Indeed, the harassment and vulnerability of SMEs in Kenya has been evidenced in various separate incidents supported by reports from different news media. For instance the press often reported of the raging battle between City Council Askaris and Hawkers over the demolition of structures along road reserves, destroying property worth thousands of shillings with more than a thousand hawkers affected. On separate incidents,

various markets in the city were burnt to the ground through arson, destroying millions worth of merchandise (clothes, mitumba) starting with Freemark, Gikomba, and Kawangware markets amongst others. Harassment towards street hawkers and garment sellers etc. is still common in Nairobi. This underlines yet another contradiction in the government's commitment to its prolific Sessional papers in support of promoting SMEs.

Gatheru and Shaw (1998) observe that to do business in Kenya, a firm reportedly needs an estimated 15 licenses a year, the processing of which costs 233 hours a year. In addition, harassment of firms by officials under guise of enforcing licensing requirements is common. A good part of legal processing costs (estimated at 66%) constitutes bribes and other payments. These additional costs are a major hindrance, particularly to SMEs and affects investment decisions, particularly the decision to expand in a profound way. Licenses serve as a barrier of movement into formal status, complicate obtaining financial support and title to land, and provide an opportunity for extortion and graft on the part of local and national efforts.

Macharia (1997) comes to similar findings but adds that small enterprises have had to face many months before acquiring licenses for their operations due lengthy and inefficient red-tape bureaucracy. They also have to deal with poor infrastructure despite the government's rhetoric that it is in their support. This he argues is a perfect illustration of the gap between policy on paper and implementation on the ground. Dondo (1993) also notes that since independence in 1963, very substantial funds have been spent to implement government policies and programs and in building institutions, specifically

aimed at promoting the small enterprises sector. He observes that the results to date have not been satisfactory to date due to the poor coordination among implementing agencies. In addition many programs have not been based on their adequate needs assessment.

According to Mwarania (1993) as of December 1990, Kenya had 28 commercial banks. These banks had 400 branches, sub-branches, agencies and mobile units and accounted for about 66% of the total deposits in the economy argues that nearly all the lending done by commercial banks is short-term (i.e. 2 years or less) and the bulk of their credit is in the form of bank overdrafts. As the bulk of these overdrafts are rolled over they effectively become loans.

Dondo (1993) points out that a few major banks dominate the banking system in Kenya namely: Kenya Commercial, Barclays, Standard Chartered and National Bank of Kenya. Together these banks account for over 60% of the commercial bank's deposits and credit volume. He deduces that these commercial banks are generally conservative in their lending policies in an effort to be prudent in safeguarding their depositors' money. In particular, they do not emphasize the financing of the small enterprises sector, as they do not regard the sector as an important part of their portfolio.

GOK (1992) cites that it is difficult to determine how much has been loaned to the small-enterprises sector by commercial banks and other Non-bank financial institutions because their reporting to the Central Bank of Kenya does not specifically require this

information. However it is known that their loans to the small and Juakali enterprise sector represent a small fraction of their total loan portfolio.

Helmsing et al. (1993) arrives at similar conclusions but they however add that the exact confirmation of this conjuncture is often difficult because the reports they file with the Central Bank do not disaggregate lending by size of enterprise. The conjuncture is based on the fact that most commercial banks' lending has land, buildings and equipment as the main form of collateral.

Banks and DFIs also provide certain services to SMEs clients before and after extending credit. These services are too expensive and include preparation of feasibility studies, project appraisal, project implementation, project supervision, training, rehabilitation and other management advisory services. Unlike DFIs, commercial banks are not allowed to levy any charges for these services (GOK, 1992).

Mwarania (1997) is content that the future role of NGO's as providers of credit to SMEs, is tied up with the continued flow of external donor support to them. This is because few of them are financially viable without this support.

## **2.7 EFFECT OF CREDIT ON SMEs**

Oketch (1995), cite lack of credit facilities as one of the most critical problems facing the SMEs sector. In line with this Mullei & Bokea (1993) estimated that the excess capacity resulting from capital shortage in the SMEs ranges from 18% - 42% and could at times be

as high as 58%. Hence it is not a surprise that many enterprise development specialists have a general consensus that finance makes an important contribution to SMEs growth. Indeed Oketch et al. (1995) cite that almost half (46 out of 105) of the formal enterprises support institutions in Kenya currently engage their support services in the provision of credit.

Besides this Lister (1995) found that traditional lending institutions require tangible forms of security, which makes informal sector enterprises unable to qualify for bank loans and credit, which is necessary for their growth and success. These rigid financial systems continue on structures designed to secure commercial interest such as lending to medium and large enterprises that are credit worthy.

Ony'ango (1996) comes to a similar conclusion but adds that there is a general deficiency in both the long-term working capital and funding in Kenya, where the existing regulations tend to restrict small-enterprises lending and savings. As a result loan officers have little discretion since if they made loans without tangible security they would be violating the banking systems regulations.

Mullei and Bokea (1993) offer a more valid example on formal lending institutions. They assert that the College of Banking and Finance in collaboration with the Cranfield School of Management, set up a series of management courses to commercial banking staff to train credit officers in appraisal and supervision of term loans to SMEs investments. They however found out that the impact of this training was lost within the existing bank

culture since very few of the banking staff attended the course since it was started in 1992. Only 12 from the KCB and a similar number from the Barclays Bank attended. Other banks Including the Central Bank itself did not send their staff. This perhaps explains that formal lending institutions, lack interest in doing business with the SMEs sector.

From the evidence cited above we can argue that formal institutions appear to be the least effective in providing credit to small enterprises, in general because of their regulations, that is, those of the Central Bank or the Government, or those imposed by the bank itself since secure collateral is required in addition to guarantees that can generally only be provided by companies with larger overheads. Such results offer an explanation why fewer of the very small enterprises have accessed credit than relatively large ones. This could explain why about half of the SMEs with the range of 6-10 employees have accessed credit in the past compared to less than 20% of those within the 1-2 worker range (Mullei & Bokea, 1993).

However there is increasing number of success stories about well-administered credit programs. According to Richman et al. (1991) the Grameen Bank of Bangladesh (a savings and loan association), which provides credit on the basis of a group guarantee, lends loans that average US\$ 50-60, mainly for consumption. The bank has a turnover equivalent of US\$ 3 million a month.

Working Women's Forum in Madras, India is based on the principle of group guarantee repayment too. As of June 1998, the Women's Forum made loans to 62,000 women organized groups of 10-12 participants. The groups were taught to manage funds and members helped each other repay the loans on time because if one of the women defaulted, none of the other women in her group could obtain a loan. The overall repayment rate was 96% without rescheduling. Women who received two or more loans were encouraged to set up their own groups.

## **2.8 AMOUNT OF CREDIT AND IMPACT ON SMEs**

Dondo (1991) estimated that between 1990 and 1993 organizations offering credit had provided loans worth Kshs. 2 billion. Kiiru (1991) estimated that a total of Kshs. 5 billion had been lent to SMEs by formal financial institutions including NGOs since 1963.

Tomecko and Dondo (1992) estimated that the expanding portfolio of organizations providing credit to SMEs in July 1992 was Kshs. 1.05 billion involving 8,976 borrowers. These estimates did not include all the organizations providing credit to SMEs. They reveal that SMEs finance institutions had disbursed 8,603 loans amounting to 240.7 million in 1992. Based on this information and that of the CBS estimates of 350,066 SMEs in the country, the two concluded that about 2% of the demand of SMEs credit was being satisfied implying that the existing supply of SMEs financial service is often far below its demand.

However Parker and Torres (1994) give opposing results of an estimation done by Tomecko and Dondo (1992), on the demand for credit by SMES which they refer as understated. Furthermore they claim that these estimates assumed a static demand in the sense that each individual SME gets one loan only which has been proved wrong from the experience of SMEs financier organizations like K-Rep, PRIDE and others, which have financed some SMEs more than once a year.

National MSE Baseline Survey (1993) estimated that there were approximately 910,000 SMEs in Kenya at the time employing just over 2 million people. It cited both formal assistance (either of a financial or non financial nature) as well as informal assistance from family, friends or informal moneylenders.

The study established that a vast majority that is 85% of entrepreneurs had never received assistance from any source (formal or informal) while in business. The data clearly showed that a total of (9%) of the entrepreneurs had used credit at some time, but the majority of those users had borrowed from informal sources (5%). Only (4%) had borrowed from formal sources and the remaining (91 %) relied on personal savings from their capital.

Comparably a GEMINI Baseline survey (1995) extrapolated using the same procedures followed in the 1993 survey, yielded different results. The 1995 results implied on an SMES inverse of 708,000 entrepreneurs, providing employment to only 1.2 million people. As such it showed that 10.8% had accessed credit from any source, of these 3.2 %

received credit from formal sources, 7.6% from informal sources, while 89.2% had no access to credit from any source.

Even through direct comparisons between the two surveys would imply that the SMEs sector had shrunk substantially during the survey period (with the number of entrepreneurs declining by 22% and employment by 43%) this was not the case.

Further analysis based on retrospective responses in the 1995 survey indicated that both the number of enterprises and total employment in the enterprises had increased substantially during this period. To account for these divergent findings several possible explanations were offered, however the main one was that there were differences in the principle objectives of the surveys. The 1995 survey focused primarily on collecting more extensive detailed information on incomes earned and patterns of change from a smaller sample of enterprises. As such it was less well suited to provide estimates of the overall magnitude of the sector.

However an analysis of both surveys reveals that a high number of enterprises have not received credit from any source implying that they mostly rely on personal savings, friends and informal moneylenders. This view is backed by a Tomecko and Dondo (1992) which estimated that the total effective demand for credit by SMEs in 1992, ignoring the influence of securities and interest rates was Kshs. 2.8 billion. The paper estimated that the SMEs sector which was well known for mobilizing investment funds

of its own would supply 65% of that amount, while SMEs lending institutions would finance the remaining 35%, which would amount to approximately Kshs. 1 billion.

The paper also pointed out that for the existing non commercial bank SMEs lenders to meet this demand a doubling of their portfolio would be necessary, which would imply increasing the existing institutional capacity. The portfolio was considered more of a constraint than a disbursement since the management of the portfolio implied the necessity to have additional trained staff to be able to monitor the extra load. Due to the management limitations it was estimated that most institutions could only expand up to 50% of their current portfolio. The small NGOs were seen to have greater ability to expand, while the larger organizations such as DFIs would have more difficulty. Assuming therefore that the funds were available, the maximum anticipated portfolio growth with the existing institutions would not likely be greater than 20%.

The conclusion from this analysis is that there will continue to be unmet demand for credit by SMEs for the foreseeable future unless commercial banks change their policies radically enough to accommodate more SMEs in their lending policies.

## **2.9 EFFECTS OF NON-CREDIT POLICIES ON GROWTH OF SMES**

According to Barkham (1990) education imparts organizational, analytical, computational and communicational skills. Entrepreneurs are better able to organize and supervise labour. In addition to this they are more alert to precise changing economic

conditions, with respect to new markets and competitive pressures. Earlier studies done in Kenya also note the importance of education in SED for example House (1981) found out that education is closely related to both business size and amounts of profits earned from enterprises.

Aboudha and King (1991) arrive at similar conclusions but add that education makes a difference in firm size and absolute employment performance of small and medium sized enterprises while conducting a study in central Kenya. They found that entrepreneurs with post-secondary education had the largest proportions of fast growth firms. McCormick and Kinyanjui (1993) also found that firms owned by entrepreneurs with higher levels of education grew faster than those with less education. The faster growth appeared due at least in part to the more sophisticated professional networks that educated entrepreneurs could tap.

Kenneth King (1992) on the other hand gives the importance of training. He sees it as bringing about some awareness, which lacks in technical and vocational training. He supports it and views it as bringing a socio-economic insight and cultural reality in which the informal sector is located. It also brings out benefits, whereby new skills are learnt to produce new products.

A number of studies have found that general and technical education contributes to enterprise development. Chiuta and Liedholm (1995) affirm that technical sophistication also depends on the artisan's level of formal education. Aboudha underscores the

importance of skills to enterprise development and King (1991) who found out that implicitly, the quality of technical training makes a difference in a firm's growth. Entrepreneurs trained informally in other small enterprises were less skilled and their business did not grow well as for entrepreneurs trained in the formal sector businesses.

The World Bank (1993) asserts that managerial training and experience appear to enhance entrepreneur's ability to innovate and readily adapt to new appropriate technology. An informal survey of enterprises by Improve Your Business (IYB) Kenya (1990) found that enterprises trained since 1984 showed an increase in performance of about 25% leading to an average of 120% increase in employment by these clients over a period of six years. A majority of the firms sampled in Nairobi also confirmed increases in a number of workers by 3 (300%). Kenya's experience however suggests that the quantity and content of education is as important as its quality. Shiundu and Shiundu (1990) found that not only is the Kenyan primary curriculum unable to address itself in economic activities undertaken in small enterprises, but that the basic skills in reading and writing are poorly taught.

Oketch (1992) highlights that the biggest problem in giving non financial services is due to the diversity among SMEs, which makes each firm vary considerably making "broad based" training packages or technical assistance inappropriate.

## **CHAPTER THREE**

### **3.0 RESEARCH METHODOLOGY**

#### **3.1 RESEARCH DESIGN**

A survey research design was used to carry out this study.

#### **3.2 POPULATION**

The study population comprised of small scale traders in Kenya.

#### **3.3 SAMPLE AND SAMPLING PROCEDURES**

Random sample consisting of two hundred (n=200) respondents was obtained from Nairobi Area. This is because most small scale traders are concentrated in this area. Due to time factor the sample was limited and therefore was obtained from clusters.

#### **3.4 DATA COLLECTION**

The data in this research was collected using primary sources. This was achieved by use of semi structured questionnaires and interviews.

Library research was also used to collect Secondary data. This entailed locating, integrating and evaluating evidence from documents or records, which included articles from government ministries, relevant published Sessional papers, national development plans and other relevant sources of information obtained from libraries, Governmental and Non-Governmental Organization (NGO's) offices.

### **3.5 DATA ANALYSIS**

Both qualitative and quantitative methods were used for data analysis. Quantitative methods of data analysis such as use of percentages and frequencies were employed in this research. Information was presented in the form of tables and Pie Charts.

Growth to be analyzed for the purpose of this study was limited to a period of time that is from 1990 to date. The analysis focused on the changes in following variables: - assets in an enterprise, turnover, investments, outlets and branches. These variables were used to establish generalizations or facts in answering the objective of the study, which is to determine the impact of credit financing on the growth SMEs sector in Kenya.

Content analysis, which is the systematic qualitative description of the composition of materials of the study, was used to analyze secondary data. It consisted of selecting important data from documents that includes quotations from records and official reports. This method allowed the studying of selected issues, cases or events such as; what criteria do financial and other institutional actors use in awarding credit to SMEs (specifically the choice of targets and objectives they aim to achieve), the size and impact of credit programs on SMEs, and to examine effects of different non-credit policies adopted by institutional actors towards SMEs.

Comparative analysis was used to identify differences in growth of SMEs that had access to credit versus those which did not have access to credit.

## CHAPTER FOUR

### 4.0 DATA ANALYSIS, PRESENTATION AND INTERPRETATION

#### 4.1 INTRODUCTION

The purpose of this chapter is to analyze the variables involved in the study and estimate the model described in the previous chapter. Data collected was both qualitative and quantitative. Qualitative data was analyzed using content analysis. Quantitative data was analyzed using descriptive statistics such as mean, mode and median. Data is also presented using tables, graphs and charts.

#### 4.2 RESPONSE RATE

A total of 200 questionnaires were issued to both students and administrators out of which 192 were returned giving a response rate of 92%. The table below shows the response rate of respondents.

**Table 4.1 Response Rate**

Questionnaires issued	Returned	Return rate
200	192	92%

*Source: Researcher 2011*

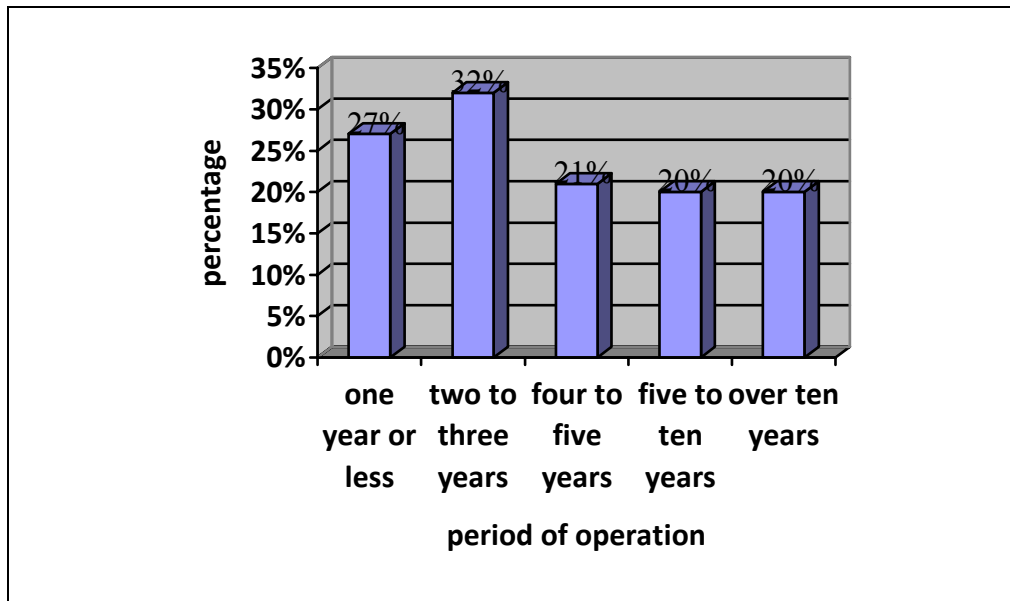
According to Mugenda and Mugenda (1999) a 50% response rate is adequate, 60% good and above 70% rated very good. This implies that basing on this assertion; the response rate in this case of 92% is very good.

### 4.3 DEMOGRAPHIC INFORMATION OF RESPONDENTS

For the researcher to assess the effect of credit on growth of small and micro enterprises in Kenya, it was considered important to establish the demographic information of respondents which included: gender, nature of business, period of operation, nature of ownership and location of business. This was done on both those students enrolled in entrepreneurship and strategic management, finance and marketing. The distribution of the respondents according to the above demographic characteristics was as shown in tables and graphs below.

#### 4.3.1 Period of operation

Fig 4.1: Period of operation of the businesses



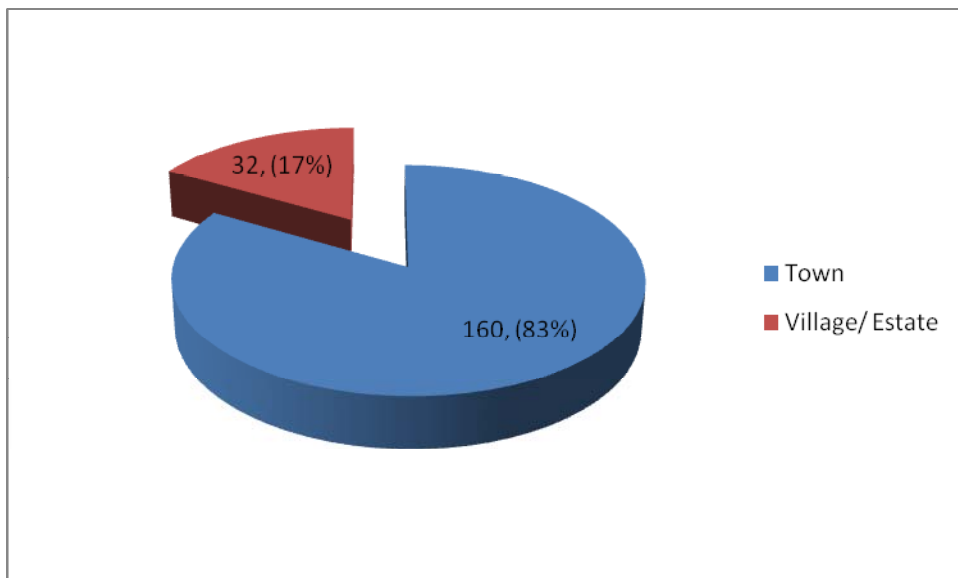
Source: Researcher 2011

From the fig 4.1 above, majority of the respondents 60 (32%) reported their businesses to have been in operation for a period of two to three years, 52 (27%) were in operation for

a period of one year or less while 40 (21%) were in operation for a period of four to five years. From this it can be deduced that majority of the businesses were infant and needed credit to enable them compete in the market.

### 4.3.2 Location

**Figure 4.2: Location of the business**

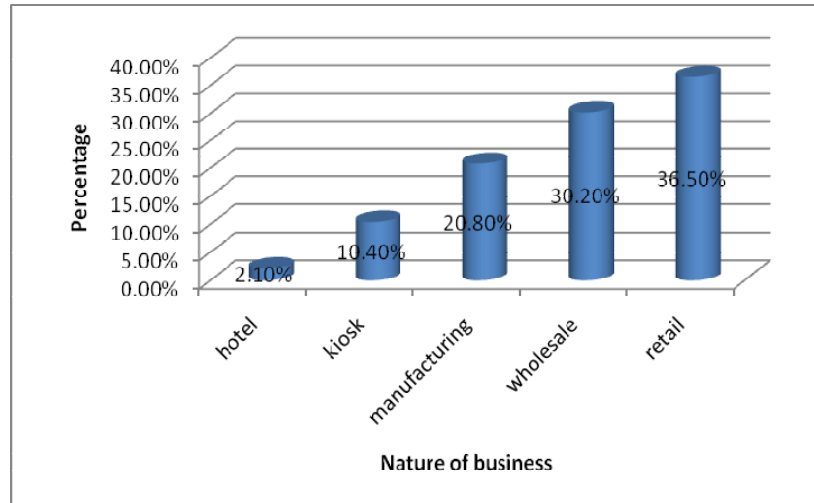


*Source: Researcher 2011*

From the figure 4.2 above, majority of the businesses 160 (83%) are located in urban areas while the remaining 32 (17%) are located in villages. From this it can be deduced that urban areas have got better facilities which attracts setting up of businesses in these areas than in the villages.

### 4.3.3 Nature of business

Figure 4.3: Nature of business

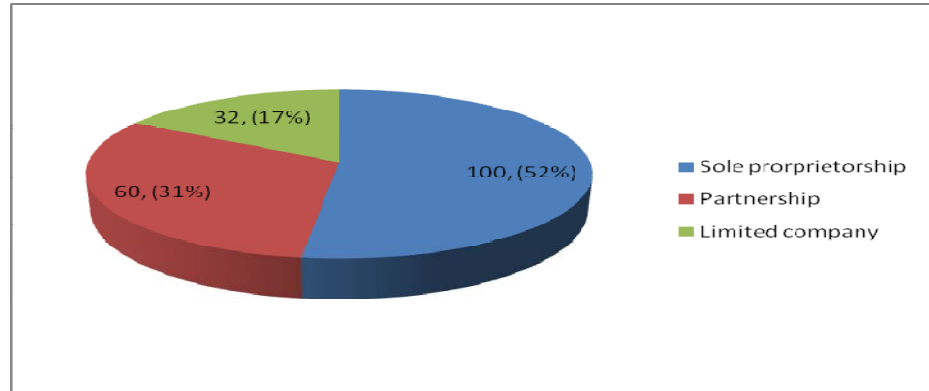


Source: Researcher 2011

From the figure 4.3 above, majority of the businesses 70 (36.5%) are in retail trade, 58 (30.2%) are wholesale traders while 40 (20.8%) are in manufacturing. From this it can be deduced that majority of the businesses are retail traders due to their nature. They are easy to start and manage.

### 4.3.4 Nature of ownership

Figure 4.4: Nature of ownership



Source: Researcher 2011

From the figure 4.4 , majority of the businesses 100 (52%) are solely owned, 60 (31%) are partnership while the remaining 32 (17%) are limited companies. From this it can be deduced that majority of the businesses are partnership and this might be due to the advantages that goesn with it.

### 4.3.5 Gender

Table 4.2: Gender of respondents

	Frequency	Percentage
<b>Male</b>	<b>160</b>	<b>83%</b>
<b>Female</b>	<b>32</b>	<b>17%</b>
<b>Total</b>	<b>192</b>	<b>100%</b>

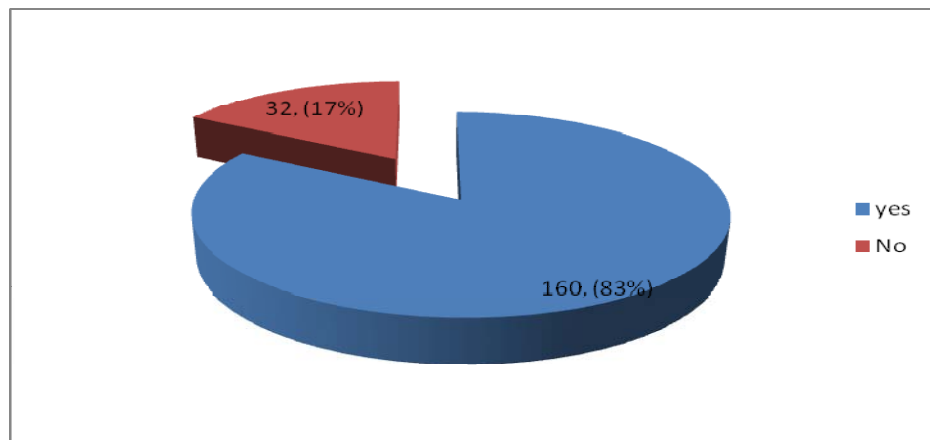
Source: Researcher 2011

From the table above, majority of the respondents 160 (83%) were male while the remaining 32 (17%) were female. From this it can be deduced that majority of the businesses are male owned.

#### 4.4 SMES ENTREPRENEURSHIP ATTITUDE TOWARDS CREDIT

Some Financial Institutions mention a very large distrust on the part of the enterprises. Entrepreneurs are scared of Financial Institutions. SMEs think if they do not have money, they cannot receive a loan. Some Financial Institutions also believe that small and micro-enterprises in particular are afraid of taking out loans because they think if they cannot pay them back.

**Figure 4.5: Access of credit**

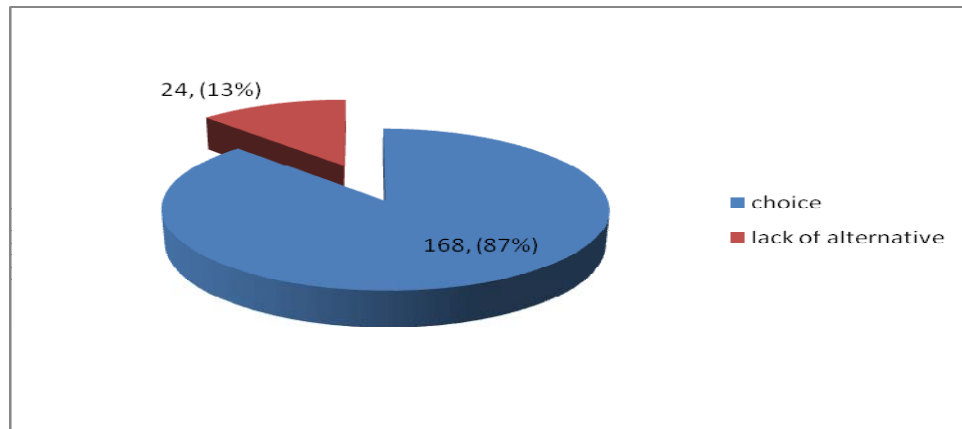


*Source: Researcher 2011*

From the figure 4.5 majority of the respondents 160 (83.3%) reported to have received credit from banks while the remaining 32 (17%) had not. From this it can be deduced that majority of the respondents had accessed credit from banks hence were not ignorant of available financial facilities.

Having found that, the researcher went further to investigate whether the respondents were obtaining credit from these financial institutions out of choice or because they did not have an alternative.

**Figure 4.6: Access of loan due to choice or lack of alternative**

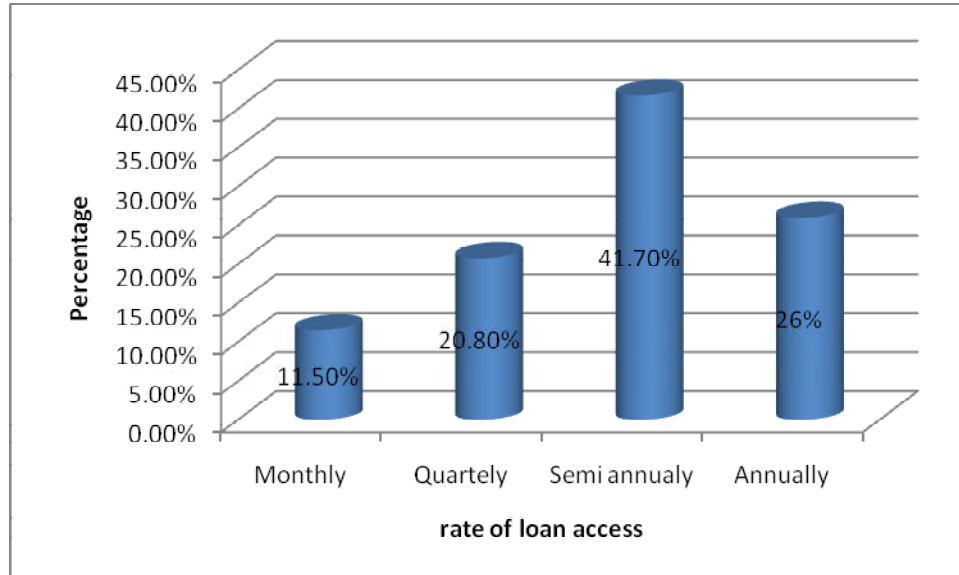


*Source: Researcher 2011*

From the figure 4.6, majority of the respondents 168 (87%) reported to have accessed credit from these banks out of their own choice while 24 (13%) was because they did not have an alternative means of credit. From this it can be deduced that majority of the respondents had a lot of confidence with these financial institutions as they were visiting these institutions to get credit out of their own choice.

The researcher went further to find out the rate at which the respondents were accessing credit from these financial institutions.

**Figure 4.7: Rate of loan access**

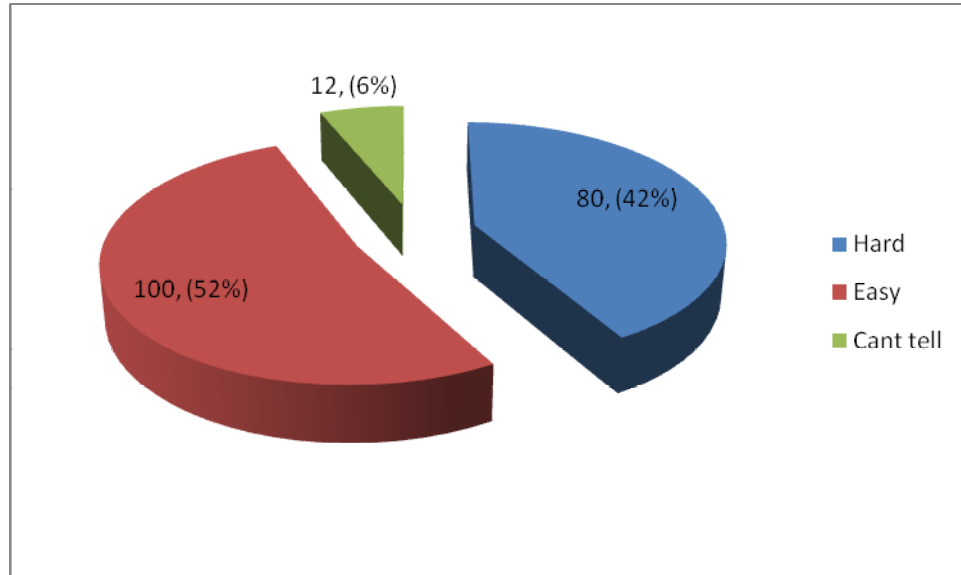


*Source: Researcher 2011*

From the figure 4.7 above, majority of the respondents 80 (41.7%) reported to have accessed credit twice a year, 50 (26%) accessed credit annually and 40 (20.8%) had accessed credit at least 3 times in a year. From this it can be deduced that majority of the respondents were accessing the loan twice a year.

Having determined the rate at which the respondents were accessing credit from these financial institutions, the researcher went further to investigate the experience of the respondents in servicing the loan.

**Figure 4.8: Experience of credit repayment**

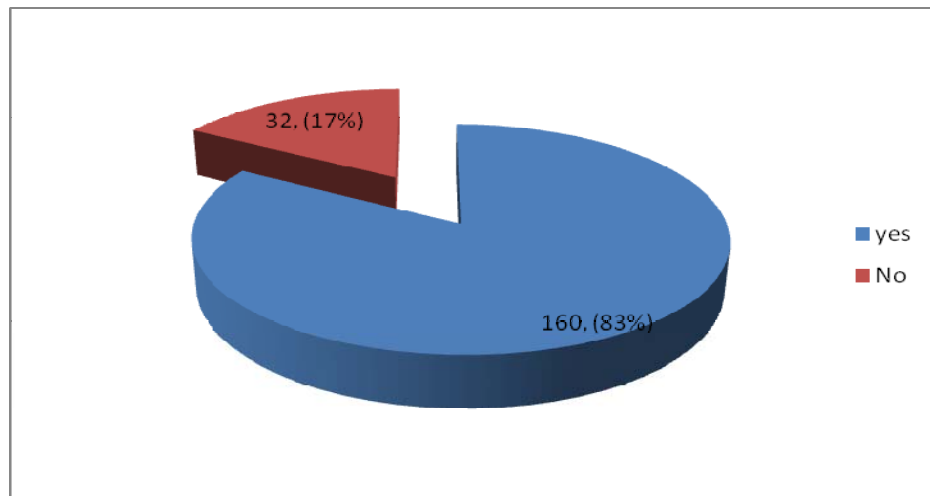


*Source: Researcher 2011*

From the figure 4.8 above, majority of the respondents 100 (52%) reported to have found it easy to repay the credit advanced, 80 (42%) reported to have found it hard while the remaining 12 (6%) couldn't tell. From this it can be deduced that majority of the respondents were comfortable in credit repayment and were doing so on time. This further shows that majority of the respondents were credit worth.

Having found out the experience of respondents in credit repayment, the researcher went further to investigate whether the respondents had found the credit useful to them.

**Figure 4.9: Usefulness of credit**

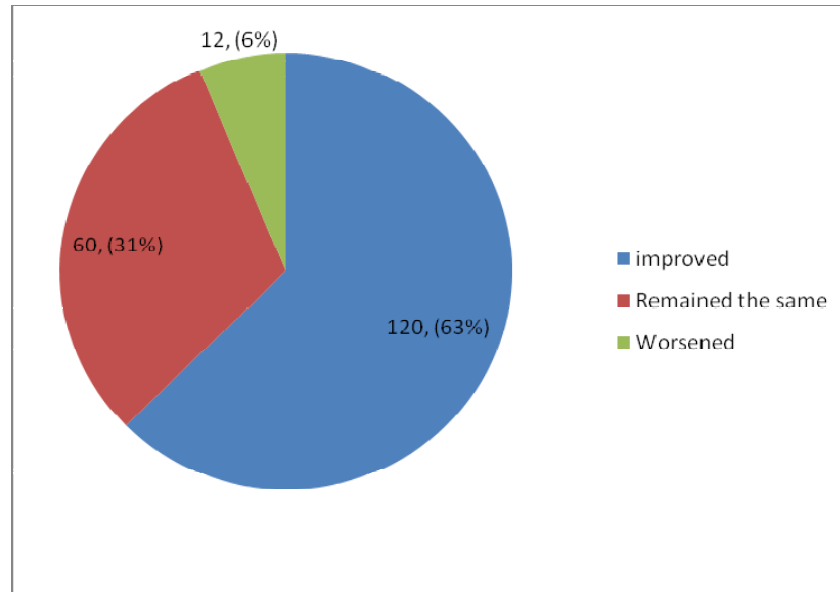


*Source: Researcher 2011*

From the figure 4.9 above, majority of the respondents 160 (83%) had found the credit advanced useful to them and their business while the remaining 32 (17%) had found the credit not to have been useful to them. From this it can be deduced that majority of the respondents had enough knowledge of how to use the credit advanced and they were making good use of it.

Having found out that, the researcher went further to investigate the impact of the credit advanced on the living standards of the respondents.

**Figure 4.10: Change in living condition**

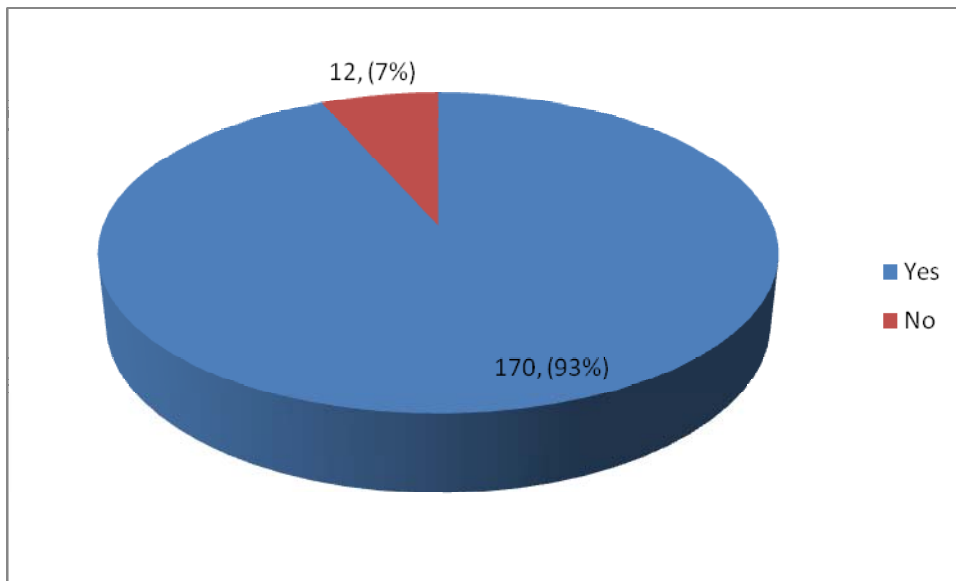


*Source: Researcher 2011*

From the figure 4.10 above, majority of the respondents 120 (63%) reported to have had a positive impact on their lives due to credit advanced, 60 (31%) reported their living standards to have remained the same while the remaining 12 (6%) reported their living condition to have worsened. From this it can be deduced that majority of the respondents had improved their living standards as a result of credit advanced to them.

Having found out that the credit has had an impact on their lives, the researcher finally sought to find out the opinion of the respondents on whether the micro finance institutions needed to come up with new products.

**Figure 4.11: Need for new products**



*Source: Researcher 2011*

From the figure 4.11 above, majority of the respondents 170 (93%) reported to have eagerly awaited for the for the micro finance institutions to come up with new products that would improve their living standards, 12 (7%) did not feel the need for micro finance institutions to come up with new products. From this it can be deduced that most SMEs were positive that the coming up of new products by SMEs would greater improve their performance and their living standards.

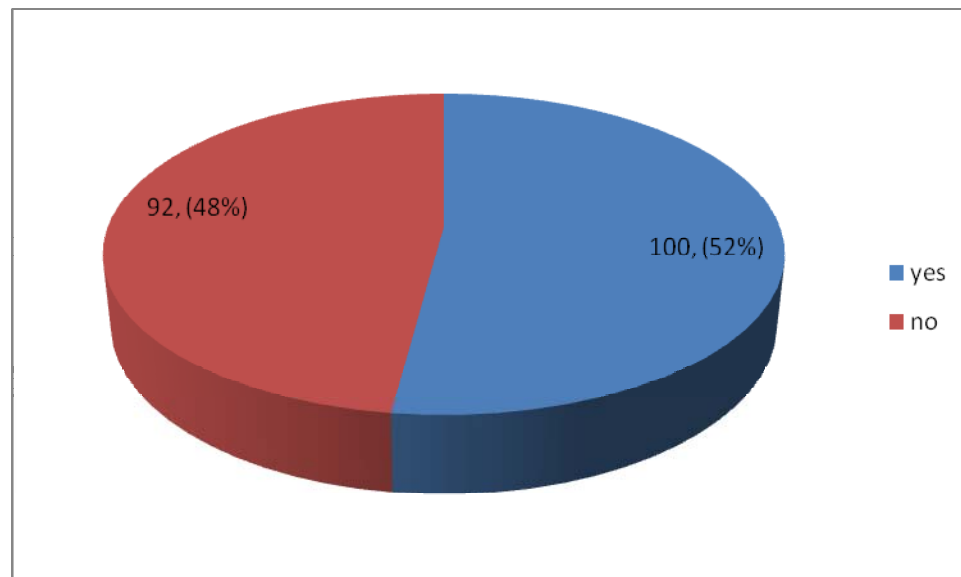
#### **4.5 INSTITUTIONAL IMPEDIMENT TO ACCESS TO CREDIT**

Referring in detail to the symptoms of management deficiencies, the Financial Institutions describe the SMEs sometimes do not have enough net profit to pay back the loan. This is partly because they maintain a very simple and insufficient bookkeeping

system. It was found that many record their turnover, but frequently forget to note their expenses. In commercial retail activities entrepreneurs are often not aware of their costs. For example, they calculate the price of importation, but do not consider transport costs and other fees, such as bribery costs. Likewise, they calculate the purchase prices at the wholesalers as costs, but do not take electricity or water into account. The SMEs capacity to anticipate is judged to be very low by the Financial Institutions.

The researcher first sought to find out whether micro finance institutions were readily available.

**Figure 4.12: Availability of Micro finance Institutions**



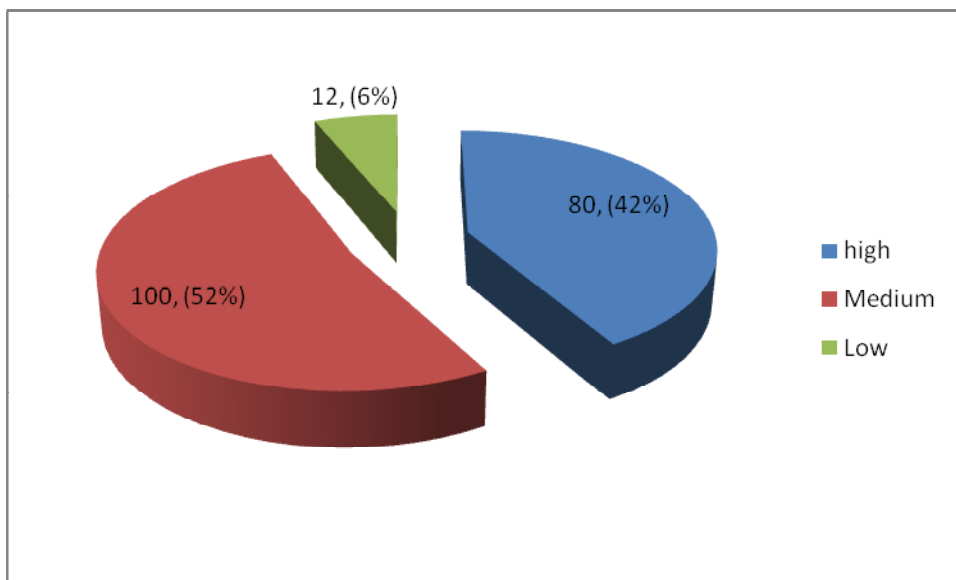
*Source: Researcher 2011*

From the figure 4.12 above, majority of the respondents 100 (52%) reported that the micro finance institutions were readily available to them, while the remaining 92 (48%) reported the micro finance institutions were not readily available. From this it can be

deduced that the micro finance institutions were readily available to most of the respondents.

Having found out the availability of micro finance institutions, the researcher went further to investigate the level of credit availability.

**Figure 4.13: Level of credit availability**

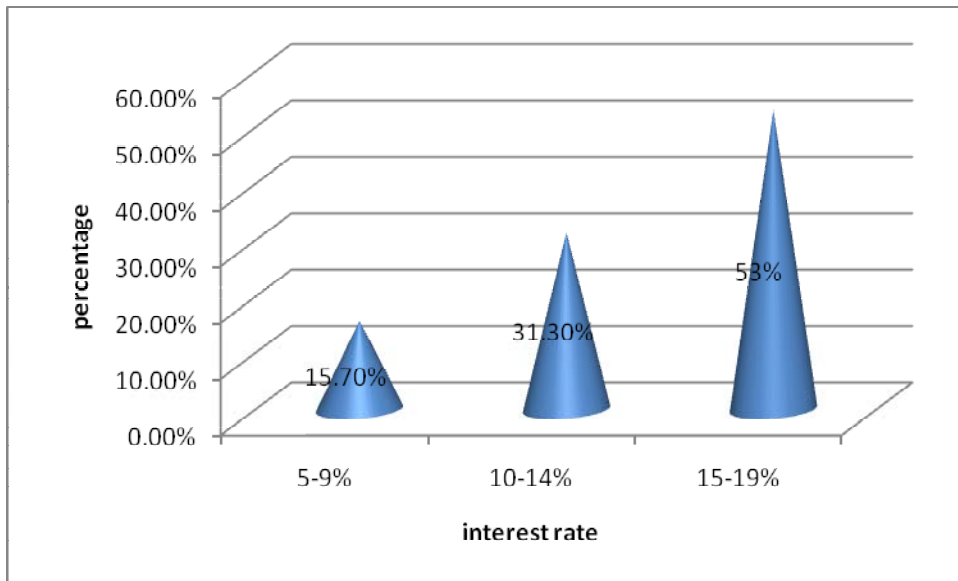


*Source: Researcher 2011*

From the figure 4.13 above, majority of the respondents 100(52%) reported the level of credit availability to have been medium, 80 (42%) reported high while then remaining 12 (6%) reported the level of credit to have been low. From this it can be deduced that majority of the micro finance institutions had moderate credit to lender to borrowers. This therefore could act as an impediment to credit access.

Having found the level of credit availability, the researcher went further to investigate the interest rate at which the institutions were charging on the credit advanced to customers.

**Figure 4.14: Level of interest rate**

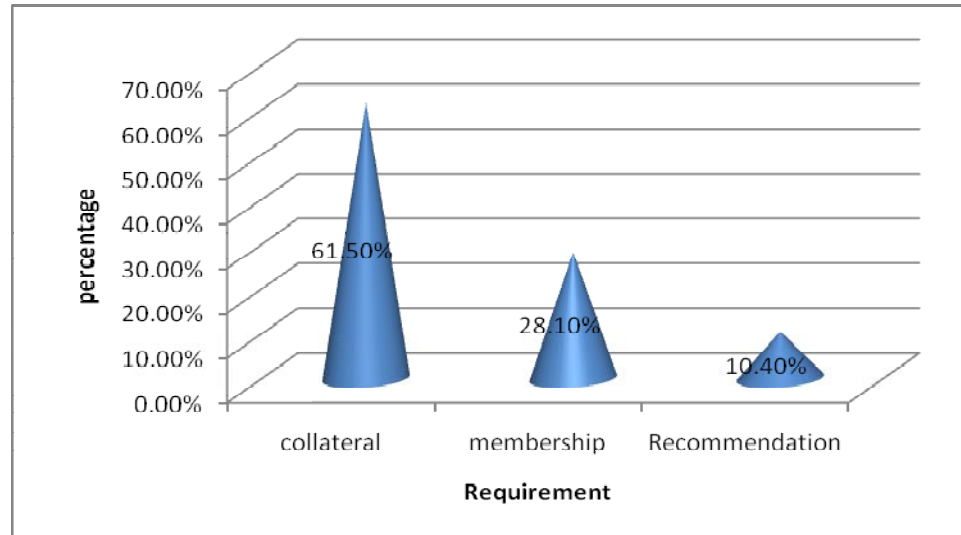


*Source: Researcher 2011*

From the figure 4.14 above, majority of the respondents 102 (53%) reported to have obtained credit from micro finance institutions at an interest rate of 15-19%, they were followed by 60 (31.3%) of the respondents who had obtained at 10-14% while the remaining 30 (15.7%) reported 5-9%. From this it can be deduced that majority of the micro finance institutions were charging a high interest rate on loan advanced.

Having found out the interest rate at which respondents were obtaining credit from the micro finance institutions, the researcher went further to find out the repayment period which borrowers were supposed to repay back the credit.

**Figure 4.15: Requirement for credit access**

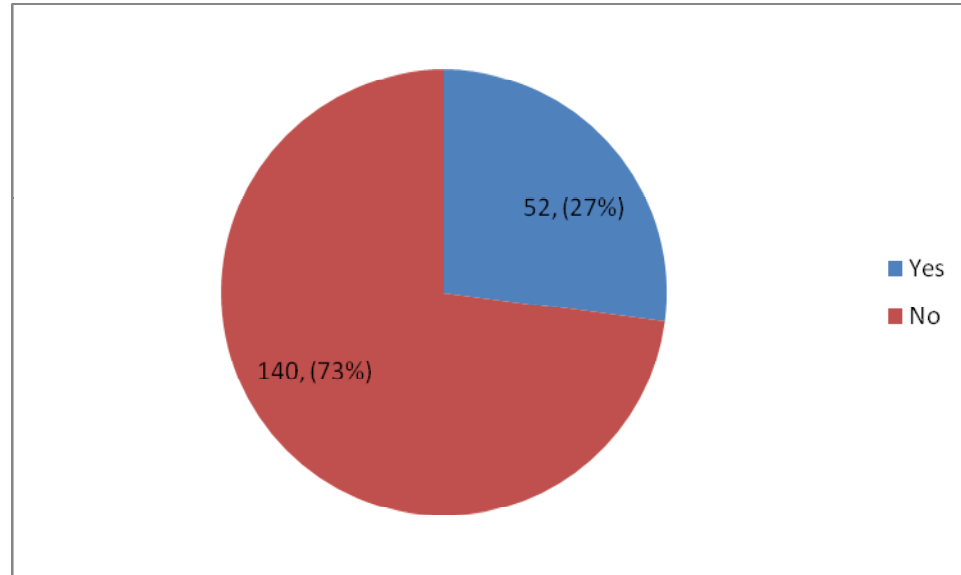


*Source: Researcher 2011*

From the above figure 4.15, majority of micro finance institutions 118 (61.5%) required collateral security from borrowers before they could lender the credit, 54 (28.1%) required the borrowers to be members of the respective micro finance while the remaining 20 (10.4%) required recommendation for them to advance the credit to borrowers. From this it can be deduced that most of the micro finance institutions always required some security to hang on.

Having found out that, the researcher went further to investigate the responsiveness of the management to customers' needs.

**Figure 4.16: Management response**



*Source: Researcher 2011*

From the figure 4.16 above, majority of the respondents 140 (73%) reported the management not to have been responsive to customers' needs while 52 (27%) were responsive to customers' needs. From this it can be deduced that most management of the micro finance institutions were not responding well to customers' needs and this can be a great hindrance to credit access.

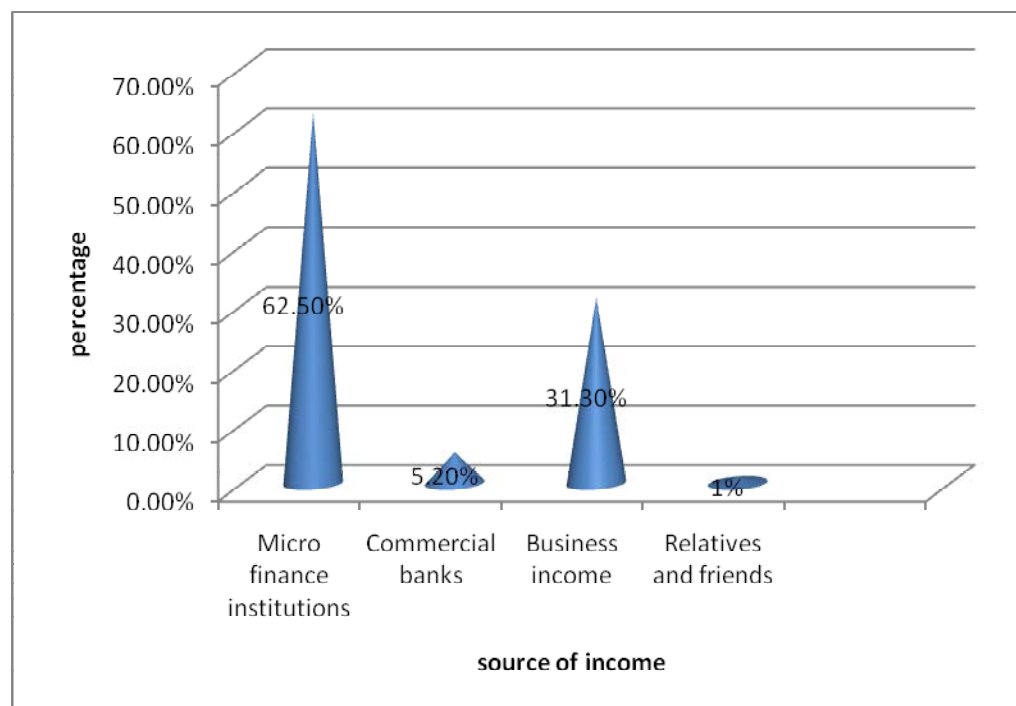
#### **4.6 EXTENT OF USAGE OF CREDIT**

The financing of small and medium-sized enterprises (SMEs) has been a subject of great interest both to policymakers and researchers because of the significance of SMEs in private sectors around the world. Data collected by Ayyagari, Beck, and Demirgüç-Kunt (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, but these factors constrain SMEs (i.e., affect their performance) more than large firms (Schiffer and Weder, 2001; IADB, 2004; Beck, Demirgüç-Kunt, and Maksimovic, 2005; and Beck, Demirgüç-Kunt, Laeven, and Maksimovic, 2006).

In order for the researcher to investigate the extent of credit usage, he found it necessary to first find out the source of finance for the different businesses.

**Figure4.17: Source of finance**



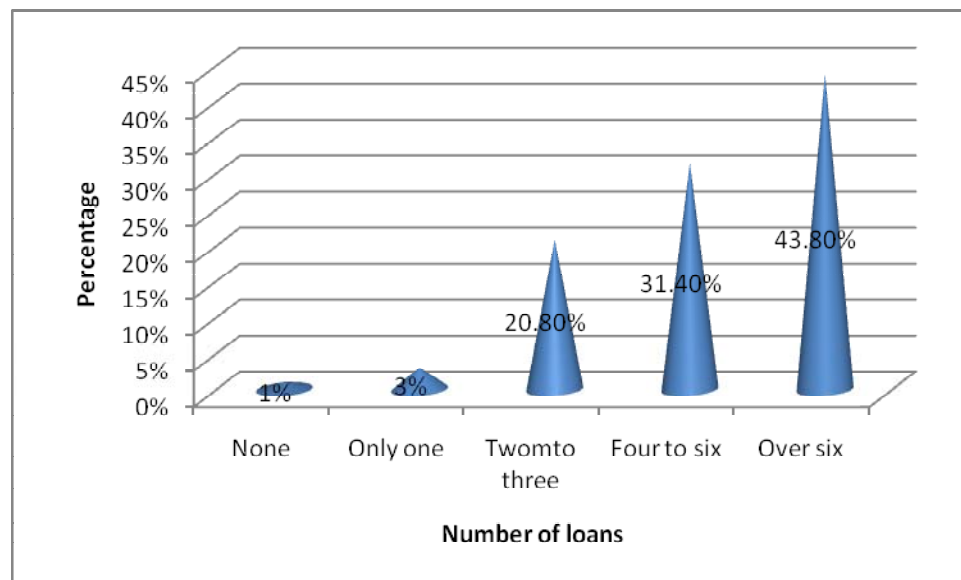
*Source: Researcher 2011*

From the figure 4.17 above, majority of the respondents 1120 (62.5%) were obtaining credit from micro finance institutions, 60 (31.3%) were re investing then income from their businesses while 10 (5.2%) were obtaining credit from commercial banks. From this

it can be deduced that most SMEs were obtaining credit from micro finance institutions due to the advantages they have over other commercial banks.

Having found out the source of credit, the researcher went further to investigate on the number of loans utilized by these SMEs.

**Figure 4.18: Number of loans utilized.**

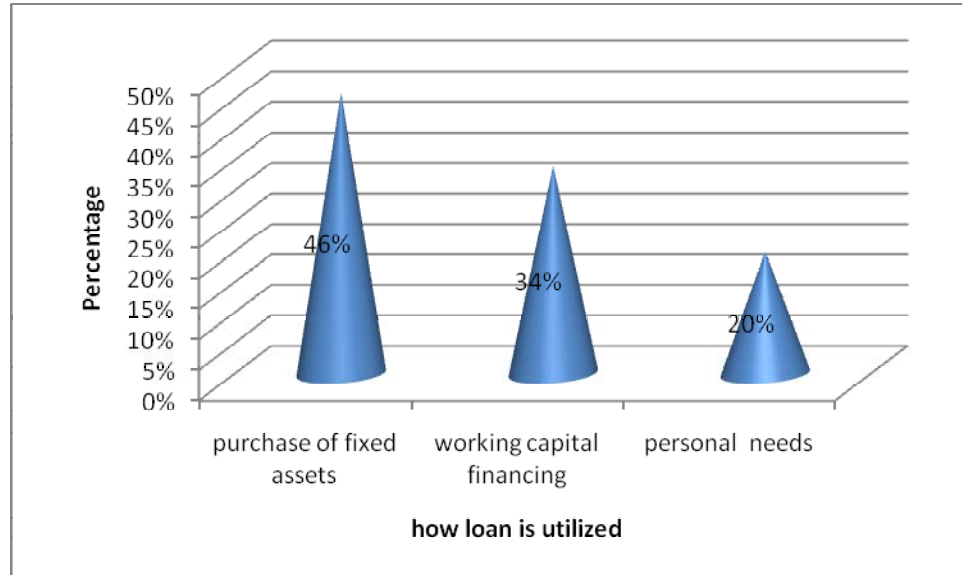


*Source: Researcher 2011*

From the figure 4.18 above, majority of the respondents 84 (43.8%) had utilized over six loans, 60 (31.4%) had utilized four to six loans while 40 (20.8%) had utilized two to three loans. From this it can be deduced that majority of the responds had used over six loans in financing their businesses.

Having found out the number of loans utilized, the researcher went further to investigate how the credit was being used in financing the SMEs.

**Figure 4.19: Loan utilization**

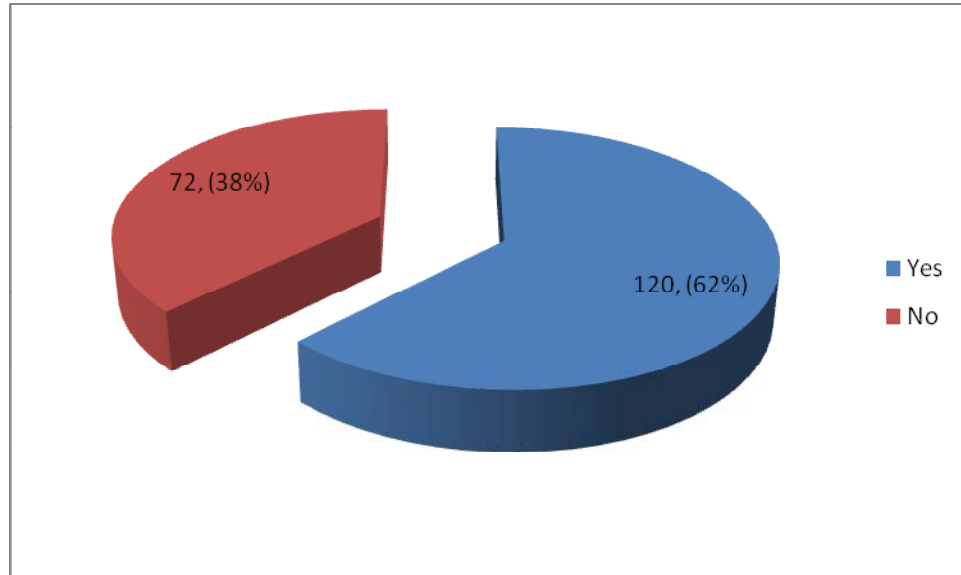


*Source: Researcher 2011*

From the figure 4.19 above, majority of the respondents 88 (46%) were using the credit from the micro finance institutions to purchase fixed assets, 66 (34%) were financing working capital while 38 (20%) were using it for personal needs. From this it can be deduced that majority of the respondents were purchasing fixed capital with the credit advanced from financial institutions. This is because these fixed assets have long life span and they tend to bring high returns.

Having found out the use of this credit, the researcher went further to seek whether the credit advance was adequate to meet the demands of these SMEs.

**Figure 4.20: Credit adequacy**

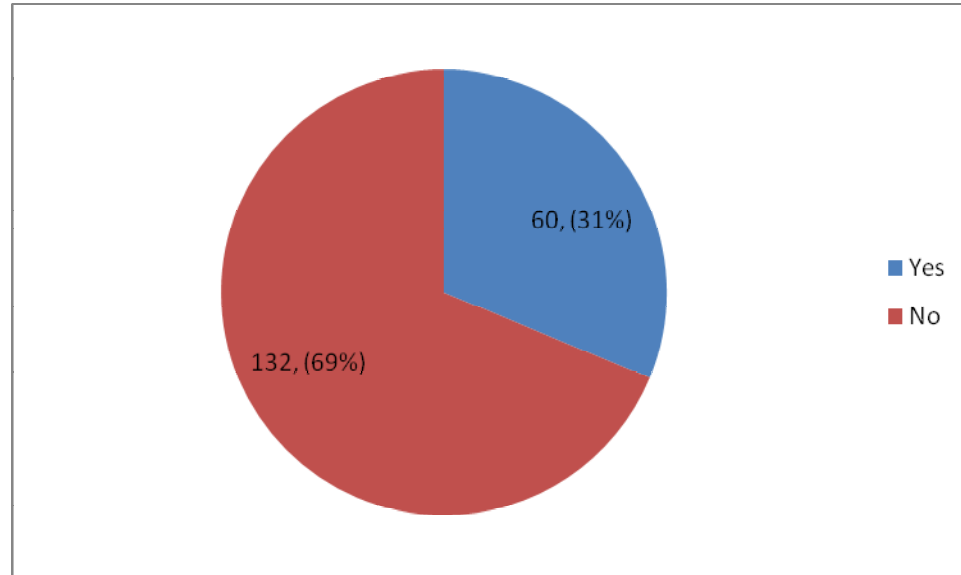


*Source: Researcher 2011*

From the figure 4.20 above, majority of the respondents 120 (62%) reported to have obtained adequate loan from these financial institutions while 72 (38%) reported not to have received enough. From this it can be deduced that most financial institutions were giving enough credit to their customers hence enabling them to meet their business needs.

Having found out that, the researcher finally sought to investigate whether respondents had attempted to borrow credit from commercial banks.

**Figure 4.21: Loan from commercial banks**



*Source: Researcher 2011*

From the figure 4.21 above, majority of the respondents 132 (69%) had not attempted to borrow loan from commercial banks while the remaining 60 (31%) had borrowed loan from commercial banks. From this it can be deduced that commercial banks are not popular among the respondents mainly because of their accessibility and facilities they offer.

#### **4.7 RELATIONSHIP BETWEEN CREDIT FINANCING AND GROWTH OF SMEs**

Oketch (1995), cite lack of credit facilities as one of the most critical problems facing the SMEs sector. In line with this Mullei and Bokea (1993) estimated that the excess capacity resulting from capital shortage in the SMEs ranges from 18% - 42% and could at times be as high as 58%. Hence it is not a surprise that many enterprise development specialists have a general consensus that finance makes an important contribution to

SMEs growth. Indeed Oketch et al. (1995) cite that almost half (46 out of 105) of the formal enterprises support institutions in Kenya currently engage their support services in the provision of credit.

**Table 4.3: Capital before and after credit advance**

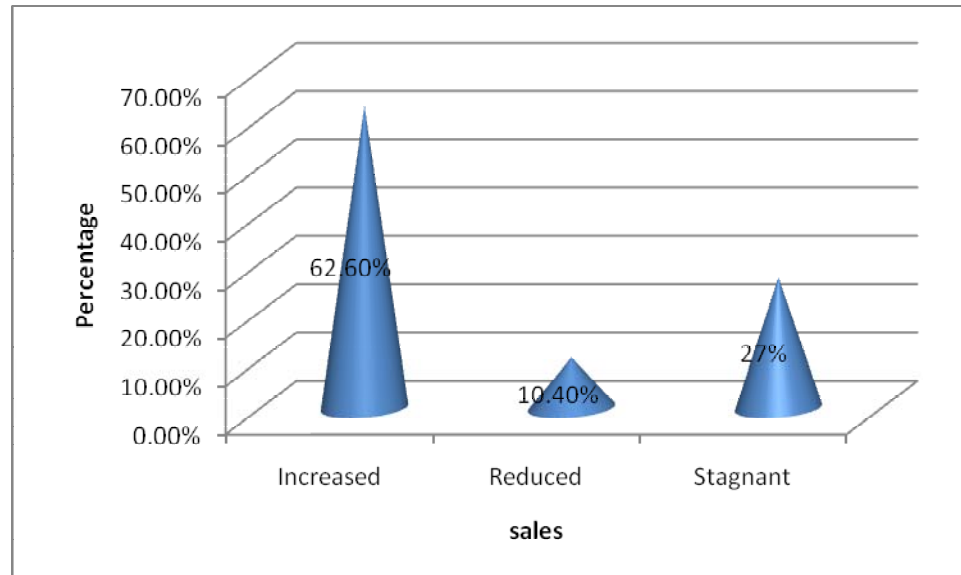
Amount	Initial		Current	
	Kes.	Frequency	Percentage	Frequency
Less than 50,000	100	52%	50	26
50,000 – 100,000	40	21%	60	32
101,000-200,000	30	16%	40	21
201,000-300,000	12	6%	22	11
Above 300,000	10	5%	20	10

*Source: Researcher 2011*

From the table above, majority of the SMEs had increased their loan after they started to acquire credit from financial institutions. The SMEs with less than Kes.50,000 had decreased from 100 (52%) to 50 (26%). This indicates a decrease of 26% which shows that 26% of all the SMEs had moved from the bottom capital bracket to other capital brackets. On the other hand the SMEs which were in the highest capital bracket had increased from 10 (5%) to 20 (10%) indicating a 5% increase. From this it can be deduced that credit advancement increases the capital available to businesses with time.

Having found out the change in capital after the business started to access credit, the researcher went further to investigate the change in sales volume after the credit was advanced.

**Figure 4.22: Change in sales volume**

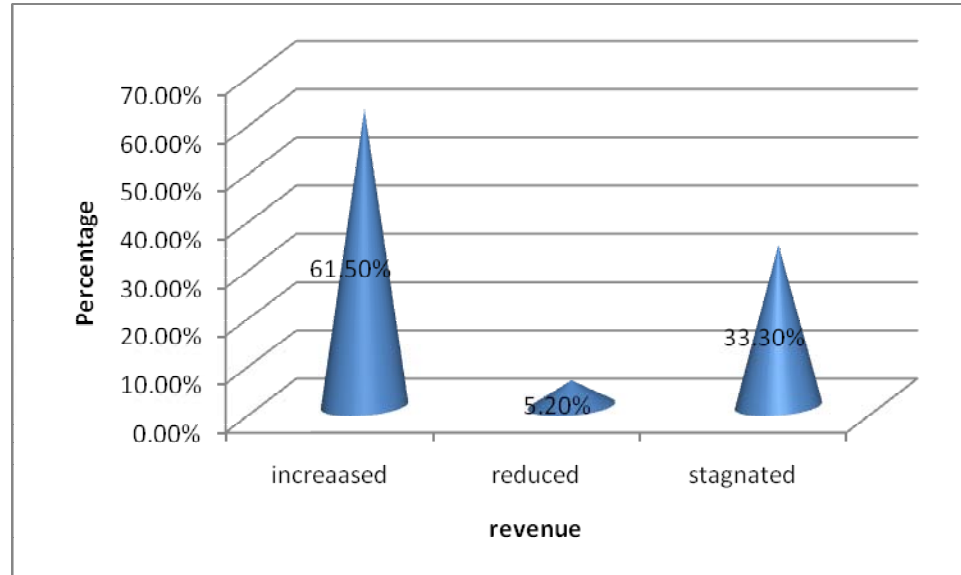


*Source: Researcher 2011*

From the figure 4.22 above, majority of the SMEs 120 (62.6%) had increased sales, 52 (27%) had stagnated while the remaining 20 (10.4%) had reduced. From this it can be deduced that majority of the SMEs had increased their sales margin and that credit leads to increase in factors which further stimulates increase in sales.

Having found out the effect of credit on sales margin, the researcher went further to investigate the effect of credit on revenue.

**Figure 4.23: Change in revenues**

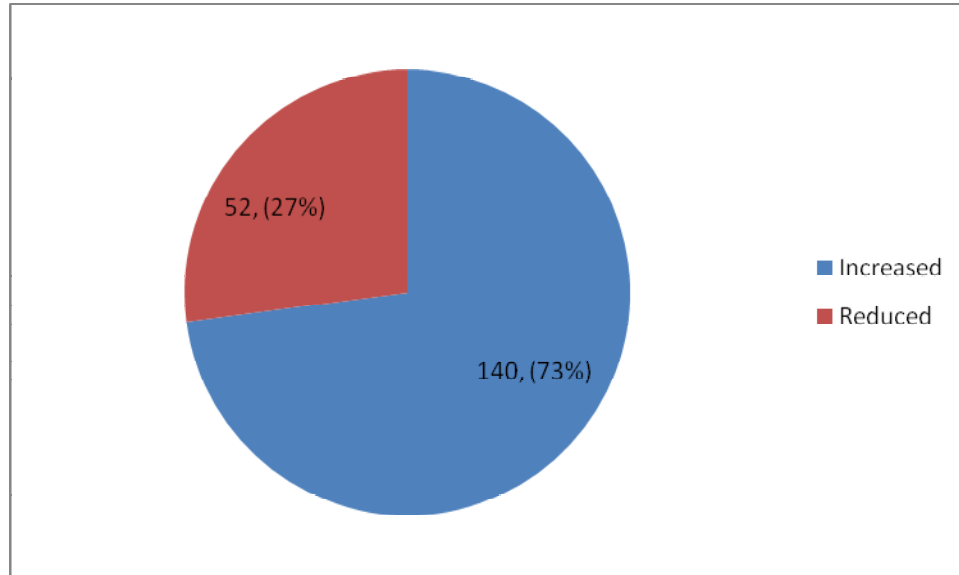


*Source: Researcher 2011*

From the figure 4.23 above, majority of respondents 118 (61.5%) reported to have increased their revenue volume as a result of credit advancement, 64 (33.3%) had stagnated while the remaining 10 (5.2%) had reduced. From this it can be deduced that majority of the business had increased their revenue collection as a result of credit advancement.

Having found out the effect of credit on revenue, the researcher went further to investigate the effect of credit on the number of employees

**Figure 4.24: Change in the number of employees**

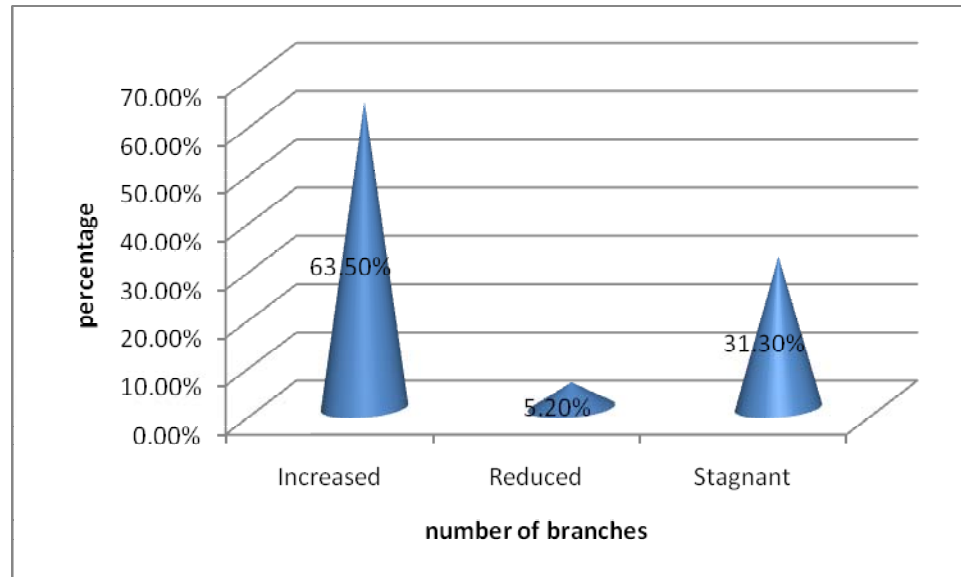


*Source: Researcher 2011*

From the figure 4.24 above, majority of respondents 140 (73%) reported the number of employees working in their businesses to have increased while 52 (27%) of all the respondents reported the number of employees to have reduced. From this it can be deduced that credit facilities leads to increase in revenue of the businesses hence making it possible to employ more employees.

Having found out that, the researcher investigated how the number of branches had changed since the businesses started acquiring credit.

**Figure 4.25: Change in the number of branches**



*Source: Researcher 2011*

From the figure 4.25 above, majority of the respondents 122 (63.5%) reported to have increased their number of branches, 60 (31.3%) had stagnated while the remaining 10 (5.2%) had reduced. Majority of the SMEs had expanded and establishing new branches as a result of credit.

## **CHAPTER FIVE**

### **5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 INTRODUCTION**

This chapter summarizes the study and makes conclusion based on the results. The policy implications from the findings and areas for further research are also presented.

#### **5.2 SUMMARY OF THE FINDINGS**

The main purpose of this study was to assess the relationship between credit and growth of micro and small enterprises (MSEs) in Nairobi.

The study was guided by objectives;

- To determine the SMEs entrepreneurship attitude towards credit.
- To establish the institutional impediments to access to credit.
- To determine the extent of credit usage.
- To establish relationship between credit financing and growth of SMEs.

##### **5.2.1 SMEs entrepreneurship attitude towards credit**

The study found out that majority of the respondents (83.3%) had at one time or another obtained credit from banks. This is an implication that many businesses were being financed through credit from financial institutions. The study further found that out of all the respondents, 87.5% who are the majority were obtaining credit from these financial institutions out of choice. This clearly shows that the respondents were comfortable and had faith with these financial institutions.

The study further revealed that majority of the respondents (41.7%) obtained credit from these financial institutions at least twice a year. This clearly indicates that majority of the respondents were repaying their loan on time since most financial institutions could not give credit to a person who had not repaid the previous credit issued. The studies also revealed that majority of the respondents (52%) found credit repayment easy. This can also be attributed to the rate at which they were accessing the credit.

From the study it can be revealed that majority of the respondents (83.3%) found credit advanced to them by these financial institutions useful to them and their businesses.

The study further revealed that majority of the respondents reported the credit to have improved their living standards. The return from the investments from the credit advanced was positive hence having a positive impact on their lives. Finally the study revealed that most respondents were eagerly waiting for these financial institutions to come up with new products which would benefit them and improve their living standards.

In theory, access to credit is supposed to enhance households' ability to manage scarce resources more effectively and protection against risk and provision for the future. It is on basis of this assertion that many governments and donor agencies emphasize development of programs directed particularly to owners of micro-enterprises (Webster, 1991). There have been several ways in which credit intervention to the MEs has been carried out, ranging from group to individual lending.

### **5.2.2 Institutional impediments to access to credit**

The study found out that majority of the respondents (93.7%) reported SMEs to be readily available. This has an implication that majority of the respondents could readily access these financial institutions and obtain the needed credit.

The study further found out that majority of the respondents (52%) rated the level of credit availability as high. Therefore the level of credit that the respondents would borrow from these financial institutions was high and this could not act as an impediment to credit access.

From the study majority of the respondents (53%) reported the interest rate charged by these financial institutions to be between 10-14% per month. This interest rate is somehow high to be charged to small businesses which are young. This can be an impediment to access to credit by small and micro enterprises in Kenya. The study further revealed that the financial institutions required the credit to be repaid on a flat rate instead on reducing balance. This would make it more difficult to service the credit advanced due to the huge amount required.

From the study it is revealed that most financial institutions required their customers to repay the credit advanced monthly and they did not give any grace period to repay the credit. This is a major impediment to credit access as most people can find it hard to make monthly repayments.

From the study majority of the respondents (61.5%) reported the financial institutions to have required collateral security before giving the credit. This is a major impediment as majority of the respondents cannot afford to provide this collateral in order to obtain credit. It further complicates issues as failure to repay the credit in good time can lead to the property used as collateral to be auctioned.

Finally the study found out that majority of the respondents (72.9%) reported management not to be responsive to the needs of the customers. The management therefore can be seen to act as an impediment to credit access.

Referring in detail to the symptoms of management deficiencies, the Financial Institutions describe the SMEs sometimes not to have enough net profit to pay back the loan. This is partly because they maintain a very simple and insufficient bookkeeping system. It was found that many record their turnover, but frequently forget to note their expenses. In commercial retail activities entrepreneurs are often not aware of their costs. For example, they calculate the price of importation, but do not consider transport costs and other fees, such as bribery costs. Likewise, they calculate the purchase prices at the wholesalers as costs, but do not take electricity or water into account. The SMEs capacity to anticipate is judged to be very low by the Financial Institutions.

### **5.2.3 Extent of usage of credit**

From the study it is found out that most businesses are financed by micro finance institutions. Majority of the respondents (62.5%) reported their businesses to have been

financed by micro finance institutions. This has an implication in that majority of the respondents feel that they have better packages than other financial institutions like commercial banks.

From the study it has been revealed that majority of the respondents (43.8%) had utilized over six loans. This clearly indicates that majority of the respondents were making good use of available credit facilities.

From the study it can be revealed that majority of the respondents (46%) had given priority to the purchase of fixed assets. These were followed by 34% who had given priority to the financing of working capital and the rest personal needs. This clearly shows that most respondents had given priority to purchase of fixed assets.

The research further revealed that majority of the respondents were accessing adequate finance from these financial institutions to finance the operations of their businesses. This clearly indicates that the respondents from these financial institutions were obtaining enough funds to finance their operations. Finally the study revealed that majority of the respondents had not attempted to borrow from commercial banks. This can be attributed to the high interest rate on credit advanced among other factors.

#### **5.2.4 Relationship between credit financing and growth of SMEs**

From the study it is revealed that majority of the respondents (62.6%) reported their sales to have increased as a result of credit advancement. This clearly indicates that there is a

positive relationship between credit financing and sales. As the businesses obtain credit, the sales volume tends to increase.

From the study it can further be revealed that majority of the respondents reported the revenue from their business to have increased as a result of credit advancement. This clearly indicates that the credit advanced was bringing back to the business good returns which translate to higher revenue. Majority of the respondents were investing the credit well hence realizing good returns.

From the study it is also revealed that majority of the businesses had increased the number of employees who work in their businesses. The number of employees had increased after start to acquire credit. This is a result of expansion of the businesses hence demanding the number of employees required to increase.

Finally the study revealed that majority of the businesses had increased the number of branches they had. As the returns from the credit advanced increased, the owners of the businesses were venturing into opening of new branches.

Dondo (1993) identifies some key institutional actors and the roles they play in the growth of SMEs. These include; Government in offering credit and extension services and in its new role as a facilitator, that is, in improving the overall climate for investments and expansion of small enterprises, NGOs in increasing growth and

sustainability of overall credit for SMEs, Commercial banks in lending and offering credit programs specifically for SMEs and DFIs in enterprise promotion.

### **5.3 CONCLUSIONS**

From the above findings it could be concluded that most of the businesses obtained credit from financial institutions. Banks have been presented as a reliable source of finance for most businesses. It was further revealed that most owners of businesses were obtaining credit from these financial institutions out of choice in order to expand their business. Majority of the respondents had accessed credit from these financial institutions at least twice in a year and they had an easy time when repaying the loan advanced. It is of great importance to note that much of the credit advanced was being put into good use as most of them had found the credit useful to them. The respondents reported their living condition to have improved as a result of accessing credit from these financial institutions. Majority of the respondents were eagerly waiting for these financial institutions to come up with new products which would further improve their living condition.

From the findings of the study, most respondents reported the SMEs to be readily available and to have a high level of credit. However these financial institutions were reported to have been demanding a high interest rate which was discouraging borrowers from accessing credit. This was acting as an impediment to credit access. Majority of the financial institutions were requiring borrowers to make monthly repayment and to make available the collateral security against the credit advanced. This was acting as a major

impediment to the access of credit to these financial institutions. The management of these institutions was acting as an impediment to credit access as they were not responsive to customers' needs.

From the study findings most of the businesses were being financed by micro finance institutions as compared to other commercial banks. Majority had received six loans over. This is an indication that credit facilities were being used maximally by these businesses. From the findings of the study most SMEs were using loan received to purchase fixed assets, financing working capital and to some extent on personal needs. The study further found that the loan provided by these Micro Finance institutions is adequate to meet the requirements of the various SMEs. However it was revealed that very few of these SMEs had attempted to borrow credit from commercial banks.

From the findings of the study, majority of SMEs had increased their sales volume out of credit advanced from these financial institutions. The revenue generated by these SMEs had also increased as well as the number of employees working with them. Of great importance to note is that the SMEs had expanded as the number of branches had increased. This therefore indicated that credit advancement to these SMEs had enabled them grow.

#### **5.4 RECOMMENDATIONS**

Low income high risk borrowers have a distinct set of attitudes, behaviour and needs in relation to credit which is specific *to* those managing it. SMEs attitude towards credit has

to be improved. Although from the study conclusions most respondents had in general a positive attitude towards credit, more effort should be made to educate them on ways of maintaining their credit score. There is need for borrowers to be educated on credit usage and how to make repayments so as to maintain their creditworthiness.

From the conclusions above, it is recommended for micro finance institutions to lower their interest rates in order for SMEs to be able to access credit more readily. The micro finance institutions are also recommended to increase the available credit and to increase the repayment period in order to make credit more available. The micro finance should adopt a reducing balance mode of repayment in order to attract more borrowers. For the vision 2030 to become a reality and poverty eradication to achieve its goals, credit has to be made available to finance the required areas of investment.

From the conclusions above, the extent of credit usage should be emphasized. Majority of the respondents were using credit to a large extent but there is still others who need to be informed on ways and means of acquiring and using the credit facilities. To reduce the unemployment level, credit should be extended to businessmen in order to create more opportunities hence reducing the unemployment levels. More emphasizes should be put in the purchase of fixed assets as they have a longer life span and their returns are much more realized.

From the conclusions above, there was a relationship between credit and growth of SMEs. There was registered increase in the level of sales, revenue and expansion of the

business. It is recommended therefore to the micro finance institutions to educate borrowers on better use of the borrowed funds in order to realize more growth. The borrowers also should devise better ways of utilizing the funds to expand and increase the output as a result of borrowed credit.

## **5.5 SUGGESTIONS FOR FURTHER STUDY**

Further research should be conducted into the attitudes towards credit, debt and help seeking among other SMEs. This should not only include Micro finance institutions but also other commercial banks and lending institutions.

In addition further research should focus on the relationship between gender and the repayment of credit in ascertaining credit rating. This will be instrumental as will aid MFIs to shift away from collateral based lending and implement group lending strategy.

Finally the researcher also suggest that a similar study should be carried out in the county to demystify the assumption that various regions have unique repayment patterns thus affecting their credit rating by basing it on the regional demographics.

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## QUESTIONNAIRE

**TITLE:** THE RELATIONSHIP BETWEEN LEVEL OF CREDIT AND GROWTH OF SMALL AND MICRO ENTERPRISES IN KENYA

Please complete this questionnaire, the information you provide will be treated confidentially and will only be used to assess the effect of borrowed funds on business growth.

Please respond by putting a tick (✓) in the box against the appropriate answer, or filling in the blank spaces.

It need not be necessary to write your name in this questionnaire.

### **BACKGROUND INFORMATION:**

1. Name of business \_\_\_\_\_

2. Period of operation since establishment

*One Year or Less*  *Two-Three Years*  *Four- Five Years*  .

*Five-Ten Years*  *Over Ten Years*  .

3. Nature of business

*Hotel*  *Kiosk*  *Manufacturing*  *Wholesale*  *Retail*  .

*Others (Please specify)*  - \_\_\_\_\_

4. Number of Employees

1-2  2-5  6-11  11 and Over  .

5. Nature of Ownership

Sole Proprietorship  Partnership  Limited Company  .

Others (Please specify)  - \_\_\_\_\_

6. Location of the Business

(i)Town \_\_\_\_\_ (ii)Village\Estate \_\_\_\_\_

7. Gender of Respondent

Male  Female  .

**SMEs ENTREPRENEURSHIP ATTITUDE TOWARDS CREDIT**

1. Do you get credit from banks?

Yes  No

2. If yes is it by choice or lack of alternative?

Choice  Lack of alternative

3. What is the rate at which you access credit from this institution?

Monthly  Quarterly

Semi annually  Annually

4. What is your experience of credit repayment?

Hard  Easy  Can't tell

5. Do you find the credit useful to you?

Yes  No

6. Is your source of credit reliable?

Yes  No

7. Since the time you borrowed what is your opinion about your living conditions/ standards?

Improved  remained the same  worsened

Others (please specify) \_\_\_\_\_

8. In your own opinion do you feel that micro finance institutions need to come up with more products?

Yes  No

If yes please explain briefly

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**INSTITUTIONAL IMPEDIMENTS TO ACCESS TO CREDIT**

1. Are SMEs readily available?

Yes  No

2. What is the level of credit availability?

High  medium  low

3. What is the interest rate of the institution?

5-9%  10-14%  15-19%

4. How is the interest rate paid?

Flat rate  reducing balance

5. What is the repayment period?

Monthly  quarterly

Semi annually  Annually

6. What is the creditworthy of the customers?

Credit worthy  Not Credit worthy

7. What requirement does the institution require to access credit?

Collateral  Membership  Recommendation

8. Is the management responsive to customers needs?

Yes  No

9. In your own words how can the institution improve its operations to enable access to credit

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#### **EXTENT OF USAGE OF CREDIT**

1. How is your Business Financed?

*Micro Finance Institution*  *Commercial Banks*  .

*Business Income*  *Relatives & Friends*  .

*Others (Please specify)*  - \_\_\_\_\_

2. If Your Business is Financed by loan, period of operation since receipt of loan

*Six Months or Less*  *Six to Twelve Months*  *One to Two Years*  ,

*Over Two Years*  .

3.(i). Number of loans utilized.

*None*  *Only One*  *Two to Three*  *Four to Six*  *Over six*

.

(ii) Period of operation since receipt of **first** loan

*Not Applicable*  *Six Months or Less*  *Six to Twelve Months*  ,

*One to Two Years*  *Over Two Years*  .

4. In percentage terms indicate how you utilized loan received.

*Purchase of Fixed Assets* \_\_\_\_\_%

*Working Capital Financing* \_\_\_\_\_%

*Personal Needs* \_\_\_\_\_%

*Others (Please Specify)* \_\_\_\_\_%

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5. Information before and after receipt of loan

	<b><u>Before receipt of loan.</u></b>	<b><u>After receipt of loan.</u></b>
<i>Maximum Sales per Year</i>	–Kshs. _____	Kshs. _____
<i>Total Cost of Assets</i>	–Kshs. _____	Kshs. _____
<i>Saving Held (bank &amp; cash)</i>	–Kshs. _____	Kshs. _____
<i>Number of Employees</i>	– _____	– _____
<i>Floor Space Occupied</i>	– _____	– _____
<i>Others (Please specify)</i>		

6. In your own opinion are loan provided by micro finance institutions adequate for your business needs?

Yes  No  .

7. Have you ever attempted to borrow from commercial banks?

Yes  No  .

*If yes why do you continue borrowing from micro finance institutions?*

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*If no what were the major obstacles?*

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**RELATIONSHIP BETWEEN CREDIT FINANCING AND GROWTH OF SMEs**

1. What is the initial capital

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2. What is the current capital

.....

3. How has sales been since you started getting credit

Increased  Reduced  Stagnant

4. How has revenue been since you started getting credit?

Increased  Reduced  Stagnant

5. Has the number of employees increased or reduced after acquiring credit?

Increased  Reduced  Stagnant

6. How has the number of branches been after starting to acquire credit

Increased  Reduced  Stagnant

-END-

**Thank your for your valuable time and responses.**