SELECTED FINANCIAL FACTORS INFLUENCING FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KENYA

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A Research Project Submitted to the Graduate School in Partial Fulfillment of the Requirements for the Master of Business Administration Degree of Egerton University.

EGERTON UNIVERSITY

MAY, 2021

DECLARATION AND RECOMMENDATION

Declaration

I, the undersigned, declare that this project is my original work and that it has not been presented in this or other university or institution for academic credit.

Signature…. .. Date: … 29/5/2021

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CM16/0011/11

Recommendation

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

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DEDICATION

I wish to dedicate this work to my family who have been a great inspiration to me and for moral support during my study and for accomplishment of this research project.

ACKNOWLEDGEMENTS

I would like to acknowledge the following persons whose contributions facilitated the completion of this research project. First, special thanks go to my supervisor; Dr. Fredrick M. Kalui, for providing unlimited, invaluable and active guidance throughout the study. His immense command and knowledge of the subject matter enabled me to shape this research project to the product that it is now. I also acknowledge the Egerton University for the great contribution through provision of resources and manpower to help me to pursue this Degree of Master of Business Administration (Finance). Further, I acknowledge my lecturers in the University for their Contribution to my coursework and the development of this research project.

ABSTRACT

Small and medium enterprises plays major role in the growth of the national economy through employment creation and poverty alleviation. Most of them perform poorly and about half of them are closed within the first year of operation from literature review. The study sought to determine the influence of access to credit, starting capital, interest on loans and loan re-paying plans on the financial performance of small and medium enterprises in Kenya. The study adopted explanatory research design. The target population was heads of finance departments in the 100 top small and medium enterprises in Kenya. Stratified random sampling technique was used to select 80 small and medium enterprises. This study used primary data, which was collected by structured questionnaires from the sample. A pilot test was conducted to assess the validity and reliability of the research instrument. Data was analyzed by use of both inferential and descriptive statistics with the help of statistical software SPSS. Descriptive statistics composed of calculation of percentages, and frequencies, measures of central tendency (mean) measures of dispersion (standard deviation). The results were presented using tables and figures which included bar charts and pie charts. The study found that access to credit had a positive and significant influence on the financial performance of small and medium enterprises in Kenya (β_1= 0.402, P-value=0.000). In addition, the study revealed that starting capital has a positive and significant influence on the financial performance of the small and medium enterprises in Kenya (β_2= 0.195, P-value=0.021). The study also established that interest on loans had an inverse and statistically significant influence on the financial performance of the small and medium enterprises in Kenya (β_3= -0.245; P-value=0.003). Loan repayment plans had a positive and significant influence on the financial performance of the small and medium enterprises in Kenya (β_4= 0.347; P-value=0.003). Combined, access to credit, capital, loan interest and re-payment plans have a statistically significant influence on the financial performance of small and medium enterprises in Kenya. The study recommends that the financial institutions and the government Authorities should allocate more funds to the Youth Enterprise Development Fund and Women Enterprise Fund from the current 18.7% of the National budget. Develop a saving culture where they can save money in commercial banks, microfinance institutions and Sacco's so that they can access to starting capital from these financial institutions. Small and medium enterprises in Kenya should have proper records and develop a saving culture so as to access credit and starting capital from financial institutions.

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LIST OF ABBREVIATIONS AND ACRONYMS

ANOVA	Analysis of Variance
GDP	Gross Development Product
ICT:	Information and Communication Technology
KNBS	Kenya National Bureau of Statistics
KPMG	Klynveld Pick Marwick Geordeler
MFIs:	Microfinance Institutions
MSMEs:	Micro, Small and medium-sized enterprises
NACOSTI:	National Commission for Science, Technology & Innovation
ROA	Return on Assets
SMEs:	Small and medium-sized enterprises
SPSS:	Statistical Package for Social Sciences

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

The small and medium enterprises sector in Kenya is progressively becoming a more important machine for gainful occupation and wealth formation which in turn steer economic growth. Medium enterprises are the current engine to economic development, income generation and are widely recognized (Almehdawe *et al.,* 2020).The government recognizes that large companies in the industrial sector may not be able to provide all the necessary pay opportunities, given the high capital-intensity requirement in the sector, the key financial performance indicators such as credit, capital and costs associated with such credits has been viewed as a critical elements to financing of small and medium sized enterprises (Deflorio, 2018).

In Europe's developed economies, SMEs employ as much as two thirds of the total personnel employed in the private sector and total revenues range to up to 55% in the EU (Breitenecker *et al.,* 2017). In Portugal, almost all the industrial fabric is made up of SMEs. Despite their importance, studies have shown that more than 60% of these businesses close up business few months after they have started their operation (Drucker, 2014). Small businesses form the backbone of economic growth in Sub-Saharan Africa including Kenya, but the sector has faced a countless challenges that limit the growth of these businesses and hence becoming less effective in creating employment especially for the women and the youth (Gough *et al.,* 2016). Financing a firm is a complex activity, as noted by Le (2012). The owners must first assess the firm's financial requirements such as short term or the long term needs. It is very vital to also assess the cost of obtaining these finances taking into consideration the returns and disadvantages of financing through debt or equity, taking into account the firm's special needs. Getting the right sources of financing of a firm from beginning is as important as choosing the right business. This decision will affect the firm's capital structure (Nirosha & Locke (2017). Growth of SMEs is compromised due to one major challenge, limited access to SMEs financing (Albuquerque *et al.,* 2017). It's out of this background that theories on sources of finance are considered in this study. The Pecking Order Theory dictates hierarchical orders of financing decisions of firms (Mwarari & Ngugi, 2013) noted order of preference in order internal, debt and equity financing respectively. Small companies do select internal sources; however this will depend on firm's internal funding capacity to meet its needs at each stage, Agrebi (2009).

Cost of Credit includes loan processing fees, interest rates, loan negotiation fees, loan insurance fees, legal fees and traveling fees that a businessperson has to incur to get a loan (Gitari, 2012). The other significant area singled out by Obura and Matuvo (2011) is the fixed cost associated with acquisition of information concerning the SME by the lending bank. In essence, high transaction costs do not only increase the cost of borrowing, but restrict access to external borrowing by SMEs (Van AardtSmit & Olawale, 2012).

According to Aabii (2014), banks have often been criticized for considering their super normal profits more than the plight of SMEs seeking financing. Banks usually argue that high cost credit is beyond their control as the base interest rates are set by central banks, however, in reality, the interest rates that banks offer to SMEs are far higher compared to the base rate offered central banks (Charbonneau & Menon, 2013). For instance, in Kenya, over the last five years, the central bank base rate has been 8%; however, banks have been charging SMEs up to 24% to access credit facilities. This is 16 points above the base rate (Wanjohi, 2010). The exploitative nature of banks towards SMEs seeking loans pushes costs of credit high, and thus, unaffordable for most SMEs.

1.1.1 Small and Medium Size Enterprises in Kenya

A small and medium enterprise refers to a firm, trade, service, industry or a business entity with employees ranging between 10 and 99. In Kenya, the classification of enterprises is primarily by the number of employees engaged by firms and their turnover. The Micro and Small Enterprises (MSE) Bill 2012 defines small enterprises as those firms, trade, service, industry or business activities that post an annual turnover of between Ksh. 500, 000 and Ksh. 5 million and have an employee list of 10 to 50. Medium enterprises are therefore firms with between 51-100 employees and a capital investment of not more than Kshs 30 million.

The definition of small and medium size enterprises is broad and wide depending on the nature size and numbers of employees that are engaged. They are mainly defined in terms of their characteristics, which include the size of capital investment, the number of employees, the turnover, the management style, the location and the market share (Nirosha& Locke, 2017). Small and medium-sized enterprises (SMEs) are independent firms which employ less than a given number of employees. This number varies across countries. The European Union (2011) defines SMEs as any entity engaged in an economic activity, irrespective of its legal form. Enterprises qualify as micro, small and medium-sized enterprises (SMEs) if they fulfill the

criteria laid down in the recommendation of the European Union. In addition to the staff headcount ceiling, an enterprise qualifies as an SME if it meets either the turnover ceiling or the balance sheet ceiling, but not necessarily both.

The Micro, Small and Medium Enterprise Act (2012), Kenya which combines employment with other measures of size and defined a Small Enterprise as a business that has sales of between Ksh. 500, 000 – Ksh 1 million a year, or has 10–50 people working in it (SME Act, 2012), therefore based on the above varied definitions, this research categorized the Small Enterprises as firms size with workers between 10 and 50 while the medium Enterprises are firms with workers between 50 and 200. In Kenya, "micro-enterprises" are those with 10 or fewer workers, Censuses indicate that micro and small enterprises comprise the major portion of enterprises in Kenya, while there are a few medium enterprises (Kithusi, 2015).

The small and medium enterprises (SMEs) play an important role in the Kenyan Economy. SME's in Kenya contributed to over 50 percent of new jobs created in the year 2005. Despite their significance, past statistics indicate that three out of five businesses fail within the first few months of operation; Negative perception towards SME's is one of the most significant challenges facing the performance of SMEs. Potential clients perceive small businesses as lacking the ability to provide quality services and are unable to satisfy more than one critical project simultaneously whereas larger companies are opted for their clout in the industry and name recognition (Egbetokun *et al.,* 2010).

Access to finance has been identified as a prevailing constraint facing SMEs (Milovanovic & Wittine, 2014). A World Bank study found that about 90% of small enterprises surveyed stated that credit was a major constraint to new investment (Jabeen, 2014). Sansa (2019) also found that, there is limited access to financial resources available to smaller enterprises compared to larger organizations and the consequences for their low growth and development. This stems from the fact that SME's have limited access to capital markets partly due to the perception of higher risk, informational barriers, and the higher costs of intermediation for smaller firms (Mwende *et al.,* 2019). Previous studies have identified a growing gap in the financial support offered to Ghanaian SMEs. The high interest rates, collateral requirements and the cumbersome processes have often been mentioned as the main impediments to SME's access to bank loans in Ghana (Popa & Ciobanu, 2015).

A number of studies have found that there is a correlation between firm age and access to credit. Being in the business for many years suggests that the firms are at least competitive on average. On the other hand, the new firms are not likely to meet the collateral requirements of the banks since they have not accumulated sufficient assets. Combined with the absence of information on their financial records, this makes it difficult to lenders to assess lending proposals submitted by new firms. The studies conducted in the past have found that the financing constraints are particularly severe in start-up enterprises and relatively young firms that are three years old or less.

1.1.2 SME's Financial Performance Measurements

Performance indicators are the heart of the performance measurement system and represent indispensable means for making performance based management decisions. The performance measurement system is a basic building block of total quality management. Categories of performance measurement include process measures, inputs, outputs and outcome measures for immediate, intermediate and long term (DeGroff *et al.,* 2013).

Key Performance Indicators are quantifiable measures, agreed to beforehand, that reflect the critical success factors of an SME. These are the means used to occasionally judge the performances of an SME, commercial entity departments and employees. Historically, KPI have focused on financial measures such as growth of a firm in terms of, profit, cash flow and return on investment in order to analyze performance (Halim *et al.,* 2017).

Financial performance measures are the most frequently used measures of output and efficiency in SME's, with less concern to non-financial performance measures. These measures are viewed as traditional measures that lead to sustainability of a firm, hence they need to be properly managed and controlled.

SMEs performance may be measured using financial or non-financial or operational measures (Schayek, 2011). Financial measures of performance can be referred to as the results of a firm's operations in monetary terms (Business Directory, 2011). Financial measures of performance of SME's can be done in monetary terms such as profits, incomes, expenses, savings, value of assets which can be derived from the books of a firm or can be found in the firm's profit and loss statement or the balance sheet. Financial measures are also referred to as objective measures because they can be individually measured and verified (Kellen, 2013).

Return on Assets (ROA): Cooke and Uchida (2014) suggest that the return on assets (ROA) is used as a vital measure of profitability. The ROA provides information about how much profits are generated, on average, by each unit of the assets of the firm (Petersen & Schoeman, 2012). Return on assets (ROA) is the ratio of net income after taxes divided by total assets and it shows how well management uses the firm's real investments wealth to produce profit (Ongore, 2013). Return on assets indicates how profitable a firm is relative to its assets. Nyabwanga *et al.* (2013) assert that return on assets must be positive and the standard figure for return on assets is 10% - 12%. The higher the return on assets the better as the firm is earning more money on capital invested. ROA is considered an indicator of how efficiently a firm is being operated with the assets available to the firm.

1.2 Statement of the Problem

There have been various initiatives meant to assist SMEs funding over the years. Tremendous efforts have been directed to enhance the availability of funds from the government, financial institutions and other donors to support SME's in the country. Despite all these many SMEs have been in dire need of credit to boost their capital, and when these funds become available the high cost charged inhibits financial performance by being a big cost that hinders growth of firms. Very long process to acquire credit, bureaucracy and poor delivery channels are some of the other reason given for the slow impact of the funding to SMEs (Obwori *et al.,* 2012). The primary objective of these funds were to boost growth in SME's financial performance, little has been achieved (Kinuthia & Akinnusi, 2014). An overview of literature shows that many of these enterprises cannot still access finance due to various factors that vary from money being channeled or embezzled by the officials mandated to manage these funds and the high cost of these funds.

The 2016 National SME Survey reported that 46.3 per cent of the establishments (small and medium enterprises) in Kenya were closed within the first year of operation. About 29.6 per cent of the businesses closed due to shortage of operating funds, increased operating expenses, declining income and losses incurred from the businesses. In addition, 4.2 per cent of business start-ups got capital from families and/or friends, 5.6 per cent got financing from banks, and the rest used family/own funds as the main source of start-up capital. As such, start-ups as well as other small and medium enterprises experience challenges when accessing credit from financial institutions. As indicated in the survey, out of the total loans applied by licensed SMEs in the years between 2014 and 2016 (Ksh.707.3 billion) on 9 per cent was given by financial

institutions (Kenya National Bureau of Statistics, 2016).In addition, the report showed that some entrepreneurs avoid taking loans due to the high interest rates or lack of collateral to support the loan application. Other entrepreneurs did not like being in debt while others thought that loans are too much trouble not worth going through.

Several studies have been conducted on the factors affecting the financial performance of small and medium enterprises in Kenya. For instance, Nakhaima (2016) examined factors that affect financial performance of small and medium enterprises in Kenya; and Ombongi and Long (2018) studied the factors Affecting Financial Performance of Small and Medium Enterprises in the Manufacturing sector in Kenya. However, Nakhaima (2016) was limited to SMEs in Nairobi County and Ombongi and Long (2018) study was limited to the manufacturing sector in Nairobi County. In addition, while Nakhaima (2016) looked at factors like human resource, access to financing and corporate governance, Ombongi and Long (2018) looked at factors such as bank credit, technological cost and employee cost. Further, Nakhaima (2016) and Ombongi and Long (2018) adopted a descriptive research design, which cannot be used to establish relationships between variables. The study focused on the selected key financial factors such as access to credit, star-up capital, interest on loans and the loan repayment plans as a single intervention and come up with a financial model which when used as combined will sort the financing gap in SME's in Kenya. This approach has not been used elsewhere and it was conducted in Top 100 SMEs located in different parts of the country.

1.3 Objectives of the Study

1.3.1 General Objective

The general objective of the study was to determine the influence of selected financial factors on the financial performance of SMEs in Kenya.

1.3.2 Specific Objectives

The specific objectives of the study were to:-

The study was guided by the following specific objectives;

i. To determine the influence of access to credit on the financial performance of SMEs in Kenya.
ii. To determine the influence of starting capital on the financial performance of SMEs in Kenya.

iii. To establish the influence of interest on loans on the financial performance of SME's in Kenya.

iv. To determine the influence of loan re-paying plans on the financial performance of SME's in Kenya.

v. To examine the influence of access to credit, capital, loan interest and re-payment plans collectively on the financial performance of SME's in Kenya.

1.4 Hypotheses of the Study

$H_0$1: Access to credit has no statistically significant influence on financial performance of SMEs in Kenya.

$H_0$2: Starting capital has no statistically significant influence on financial performance of SMEs in Kenya.

$H_0$3: Interests on loans has no statistically significant influence on financial performance of SMEs in Kenya.

$H_0$4: Loans re-paying plans have no statistically significant influence on financial performance of SME's in Kenya.

$H_0$5: Access to credit, capital, loan interest and re-payment plans collectively have no statistically significant influence on the financial performance of SMEs in Kenya.

1.5 Significance of the Study

The study provides useful reference information to policy developers. It can be used by government, especially the Ministry of Industrialization and Enterprise development as they implement the agenda towards industrialization. This is because the study provides information on the effect of financial factors that can be used to improve financial performance of SMEs, which can in turn lead to the growth of the SMEs sector.

Donors and other support institutions to SMEs may use the result of the study to evaluate their funding policies for better efficiency and transparency. Using the information provided by the study, they can monitor the use of their funds to minimize wastage and misappropriation which is normally a major problem in the expenditure of money in these organizations. Financial institutions may benefit from knowing how financial factors influence the performance of SMEs and they ensure that the funds are more attractive and the loans extended to them are paid back and no risk of bad debts.

The findings of the study are of importance to students and other academicians wishing to explore further financial factors influencing the financial performance of SMEs in other Counties in Kenya as they will be used to use the results of the study as literature review and in the identification of gaps. In addition, the study forms a basis upon which further studies can be conducted on financial factors affecting the performance of SMEs.

1.6 Scope of the Study

The study focused on four financial factors affecting financial performance among SMEs, which include access to credit, star-up capital, interest on loans and the loan repayment plans. From the literature review and previous studies these are the key financial factors that influence SME's financial performance. The study was conducted among the top 100 SMEs located in different parts of the country. According to the Ministry of Industrialization, Trade and Enterprise Development (2018) list, the head offices of the top 100 SMEs are located in Nairobi, Kiambu, Nakuru and Mombasa. The target population was the heads of finance departments in the top 100 SMES. The study was carried out between 1stJune 2020 and 30th June 2020. The purpose was purpose of this study was to fill the financing gap that have affected almost all SMEs in Kenya.

1.7 Limitations of the Study

The study made use of questionnaires in data collection, which have low validity and knowing the accuracy of the respondents was not possible. The answers given on the questionnaires also depended on the respondent ability to recall information, thus possibility of being biased due to fear of reprisal. To mitigate this, validity and reliability of the instrument was used to determine whether what they indicate meets the required standard through pre-testing. Further, the collection of data through questionnaires depends on the respondents' willingness to answer the questions. Therefore, to avoid the fear of reprisals, respondents were assured of their anonymity and that the information they gave was used for academic purposes only, this also catered for biases as the respondents were assured of their anonymity and thus not felt compelled to portray a good image of the company.

1.8 Operational Definition of Key Terms

Access to Credit: This refers to the availability of cash for the daily operations of the company.

Credit Managers: These are persons employed by firms to manage the credit department and provide best policies concerning credit limits and acceptable levels.

Enterprise: This is a project or an undertaking or a unit of economic organization especially a business one.

Financial Performance SMEs: This is measured by profitability, return on assets and level of indebtedness among other performance indicators Cornwall, Vang and Hartman (2004) define performance as the firm's ability to continue in operation.

Financial Factors: These are selected financial factors which are key indicators to performance of most SMEs.

KPI: Key Performance Indicators are quantifiable measures, agreed to beforehand, that reflect the critical success factors of an SME.

Loan Re-Payment Plans: This refers to favorable arrangement between the lender and the borrower on the terms of repayment and especially during unfavorable economic times which provide for further negotiation plans to suit the borrowers' liquidity.

Medium Size Enterprise: This is an enterprise that employs between 50 up to 250 employees going by international standards.

Return on Assets: This measures how well or efficiently a business uses its assets to generate profit. It is a financial ratio which measures profitability. Return on Assets = Net Profit after Tax/Total assets

Small Enterprise: This is an enterprise with at least 10 and not more than 50 workers.

SMEs By KPMG: These are SME that have succeeded in progressively growing its market position in the industries in which it operates and over time; the growth has to translate into both returns for its shareholders and a fairly sound financial position.

Starting Capital: This is a financial resource in the form of money required as seed capital in the formative stages of the firm.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter reviewed literature on the effect of financial factors that influenced the financial Performance of SMEs. The chapter explained the theoretical framework, general review, empirical review, and conceptualization of the factors relating to financial performance of SME's.

2.2 Theoretical Framework

The theoretical framework of this study was based on theories of factors that influence financial performance of SMEs. This study used three theories, namely; the pecking order theory, the agency theory and the adverse selection theory.

2.2.1 The Pecking Order Theory

Pecking order theory is a financial theory which was first suggested by Donaldson in 1961 and later modified by (Myers & Majlif, 1984). The theory interrelated with capital structure of a firm. It postulates that, administrators follow a pyramid system to pick sources of finance. The pyramid gives first inclination to internal financing or reserves. If internal source is not enough, then managers would have to think of external sources. They will issue debt to generate funds. After a point when it is no longer practical to issue more debt, equity is considered as a last option.

This theory is essential to SMEs as most of them prefer the cheaper source of capital and have no intention of diluting their ownership through raising capital from outsiders. This theory was important to this study in determining whether the SMEs in Kenya financial performance has been influence by the factors from inception up to their current status. This was achieved on studying the structure of their capital and how they were able to raise starting capital successfully and any other capital they used.

2.2.2 The Agency Theory

Jasen and Meckling (1976) came up with the Agency theory in their paper on Theory of firm; Management behavior. This theory brought out very important aspect of conflict and is used widely up to today in many studies in finance as a framework. Agency theory suggests that a firm can be seen as a relationship of contracts which is loosely defined between resource

holders. An agency relationship arises whenever an individual, called principals, hires other individuals, called agents, to perform some service and then delegate decision-making authority to the agents. The primary agency relationships in business are those between stockholders and managers and between debt holders and stockholders. Agency theory is concerned with so-called agency conflicts, or conflicts of interest between agents and principals. This second type of conflict arises between debt holders and equity holders because debt contracts give equity holders an enticement to invest sub optimally. The debt contracts results in asymmetric allocation of the gains, that is, if a venture is profitable above the face value of debt, most of the gain is captured by equity holders, while if venture fails, debt holders bear all the cost because of the limited liability of the equity holders. Thus, equity holders may benefit from investing in very risky projects, even if they are value-decreasing. Such investments result in a decrease of the value of debt, while the loss in the value of equity due to poor investment is more than offset by the gain in equity value transferred from debt holders. Agency problems such as asymmetric information and moral hazards can impact negatively on the availability of credit and thus capital structure of SMEs. They named this phenomenon as credit rationing. In the Stiglitz and Weiss (1981) formulation a competitive market or a loan market may be characterized by credit rationing through interest rate manipulation by credit institutions. This is because when faced with two borrower types, a bank does not know whether a safe or risky borrower is applying for credit. Because of imperfect information (Stiglitz & Weiss, 1981) suggest that adverse selection will occur where some potential borrowers receive credit while others are denied. Adverse selection also occurs because banks prefer borrowers that are most likely to repay their loans since the banks expected returns depend on the probability of repayment. In addition, there are also problems of moral hazard. This is the risk that the enterprise will not perform in a manner sufficient to meet the repayments or the borrower.

2.2.3 The Adverse Selection Theory

The adverse selection theory of financial institutions originates from the work of Stieglitz and Weiss (1981). In his explanation, interests charged by a credit institution are assumed to have a dual role of sorting potential borrowers (leading to adverse selection) and affecting the actions of borrowers (leading to incentive effect). Interest rates thus assumed to affect the nature of the transaction and do not necessarily clear the market. Both effects are seen as a result of the imperfect information inherent in credit markets. Formal lenders insistence on collateral security rations a large number of borrowers out of the credit market, leaving only the few who

can afford the required collateral. According to Halim *et al.* (2017), lenders would like to identify borrowers most likely to repay their loans since the banks' expected returns depend on the probability of repayment. Formal institutions fail to cater for the credit needs of small and medium enterprises that are perceived to be too risky and small enterprises often have greater access to informal credit facilities than to formal sources.

Adverse selection arises because in the absence of perfect information about the borrower, an increase in interest rates encourages borrowers with the most risky projects, and hence least likely to repay, to borrow, while those with the least risky projects cease to borrow. Interest rates will thus play the allocate role of equating demand and supply for loanable funds, and will also affect the average quality of lenders' loan portfolios (Nakhaima, 2016). Lenders will fix the interest rates at a lower level and ration access to credit. Imperfect information is therefore important in explaining the existence of credit rationing for small and medium enterprises (Ombongi & Long, 2018).

The adverse selection theory was designed to apply quite generally, rather than in a specific context of informal credit in developing countries. In the latter context, the theory has often been criticized for its underlying assumption that lenders are not aware of borrower characteristics. The close knit character of many traditional rural and close knit urban societies implies that lenders possess a great deal of information about relevant borrowers' characteristics, such as business ability, size and quality of assets, and risk attitudes (Popa & Ciobanu, 2015). Criticism for this theory stems from the fact that it ignores the fact that borrowers themselves who can seek ways to assure the lender that they are not "lemon" and hence have access to credit.

This study therefore used adverse selection theory in assessing the effect of interest on loans on access to credit and the financial performance of small and medium enterprises. The theory supports use of interest rate in sorting potential borrowers rather than insisting on collateral securities which most small scale entrepreneurs lack. In Kenya most of the small and medium sized enterprises lack collaterals needed to secure loan so they prefer savings and credit co-operatives loans which are cheaper and not attached to collaterals.

2.3 Selected Financial Factors Influencing Financial Performance of SMEs

Credit constraints operate in variety of ways in Kenya where undeveloped capital market forces entrepreneurs to rely on self-financing or borrowing from friends or relatives, is not enough to enable SMEs undertake their business activities optimally. Insufficient access to long-term finance for SMEs has forced most SMEs in Kenya to rely on high cost short term finances. The various financial challenges that SMEs face include: high cost of credit, high bank charges and fees and lack of proper infrastructure (Hatten, 2012).

Credit policies in a an SME means those policies that allow a firm access to financial services which include credit, deposits, payment, insurance and other services. Credit contribute to a firms financial growth in a number of ways such as reduces the impact of cash flow problems, firm is able to build up inventories to avoid stocking out, while during economic difficulties or instability use of credit increases growth of a surviving firm. According to Nyambura (2013) access to credit is the absence of price and non-price barriers in the use of financial services.

SMEs founders provide seed capital from their savings, borrowings from friends and their family members. However, the needs of various SMEs differ (Nyan'au, 2013) and so internal financing such as equity and profits are not sufficient to drive the goals of the firm. For this reason, firm will tend to seek for external financing in form of loan credit (Huyghebaert & Van deGucht, 2012). Firms could even decide to raise capital from Venture Capital which is different from bank capital in that it typically involves higher risk and rewarded by higher returns.

Interest rates is the cost a borrower will pay for the loan taken from financial institution, this is the price paid for on- loan asset (Kongmanila & Kimbara, 2013). Interest could be in the fixed form or floating rate. The Kenya government has been concerned with the interest rates charged to borrowers and through the Banking Amendment Act No.25 of 2016m, banks were limited to charging a maximum interest rate on credit facility at a rate not more than 4% of the treasury bill. This in effect was meant to encourage saving culture among Kenyans and lower interest rates and promote growth to all sectors including SMEs.

The loan re-payment plans are the agreed terms between the borrower and the lender on how to service the loan effectively as to when installments are due. Thus repayment refers to the total loans paid on time as per the contract agreement and measurement is based on the loan

arrears Imbuga (2014). According to Sungwacha *et al.* (2014) firms that borrow loans are required to repay back their loans in regular installments soon after loan is given to them.

2.4 Financial Performance of Small and Medium Enterprises

Financial performance in SMEs is a method of calculating the results of a firm's guidelines and operations in financial terms (Wood, 2013). It's a wide concept in many areas. In an enterprise management, Sansa (2019) defines a firm's financial performance as how well the organization is managed and the value the organization brings to customer and other shareholders. Financial performance recognizes the financial strengths and weakness of an organization by instituting connections between the items of financial position and statement of comprehensive income as noted by Jabeen (2014).

According to Khan (2015), a firm measures its financial performance using financial and non-financial methods. The financial measures include turnover and profit before tax while non-financial measures focus on issues pertaining to customer satisfaction and customer recommendation rates, delivery time, waiting time and employee turnover.

Sandberg, Vinbery and Pan (2014) defined the performance of small businesses as their ability to contribute to job as well as wealth creation through business start-up, endurance and growth. Performance measurement done by various scholars is through adopting alternatives such as profitability, return on asset, liquidity, solvency, and sales growth which can be extracted from the financial statements reports.

Financial performance analysis helps in short term forecasting and growth and can be identified with the help of financial performance analysis. The analysis is a process of evaluating the relationship between the component parts of financial statements to obtain a better understanding of the firm's position and performance. This analysis can be undertaken by management of the firm or by parties outside the namely, owners, creditors, investors illustrated by Chenn (2017), financial performance measures ratios such as assets utilization efficiency ratios, deposit mobilization, loan performance, liquidity ratio leverage /financial efficiency ratios, profitability ratios, solvency ratios and coverage ratios to evaluate the banks financial performance(Bekana,2016). Financial performance is an indicator of how profitable accompany is relative to its total cost assets. It is measured by return on asset. ROA gives an idea as to how efficient management is at using its assets to generate earnings. The return on

asset is company's net income divided by its average total assets; ROA is displayed as a percentage.

2.5 Empirical Studies

2.5.1 Access to Credit and Financial Performance of SMEs

In more advanced developing countries, where there is reasonable progress in the financial institutions, SMEs may still face challenges in accessing formal finance in the form of bank loans, guarantees, venture capital, leasing and so on. Even though SMEs are the largest group of customers of commercial banks in any economy, loans extended to SMEs are often limited to very short periods, thereby ruling out financing of any sizable investments. Moreover, due to high-perceived risks in SME loans, access to competitive interest rates may also be limited (Nyambura, 2013).

Mwangi (2014) carried out a study that sought to establish the relationship of access to credit on financial growth of SME's in Nairobi County. To achieve the objective of this study, a descriptive survey design was used. The population of this study was SME's registered in Nairobi County. The researcher did a cluster sampling of 40 small and medium enterprises in Nairobi based on geographical locations. The study used secondary sources of data. Secondary data was sourced from the financial records of the SME's from year 2009 to 2013. Data collected was purely quantitative and it was analyzed using descriptive analysis and regression analysis. The study found that provision of credit to SMEs is still a fundamental problem faced by most owners and managers of SME's since most of them lack security or collateral to be able to access loan facilities. The findings of the study revealed that most owners of SME's that obtained credit were able to grow and expand their businesses significantly.

Mayabi (2013) studied the effect of access to credit on growth of small and micro enterprises in Nairobi Central Business District. The study takes on a descriptive approach with its focus on boutique business in the rapidly growing Nairobi Central Business District. The findings indicated that for businesses to grow there has to be a level of accessed credit as shown by the significant relationship of between access to credit and level of funds and financial management skills hence leading to a conclusion that an increase in access to credit leads to growth of SMEs funds and financial management skills while the same relationship exists between access to credit on level of stocks and impact on human resources.

Kinyua (2015) conducted a study effect of access to micro financing on financial performance of small and medium sized enterprises in Gikomba Market, Nairobi County. The study adopted descriptive research design. The study established that the entrepreneurs in the study area accessed different amounts of loan. The study also established that accessibility to microfinance affected the performance of SMEs to a great extent. On the influence of savings and deposits to financial performance of SMEs, the study established that savings allowed the entrepreneurs a chance to borrow from the banks and also measured their revenue generation capacity.

2.5.2 Starting Capital and Financial Performance of SMEs

Finding starting capital for most business is one of the major factors that many entrepreneurs go through and even after obtaining it, acquiring sufficient finance to sustain business growth is yet another obstacle (Hatten, 2012). Study by Kinyanjui (2015) has established how SMEs are constrained by finance. In the study carried in Nairobi among small manufacturing enterprises, Nyambura (2013) established that finance was rated among the biggest problem. The failure rates of SME start-ups are known to be high in a country like Kenya. The literature has documented repeatedly that about 50% of new entrepreneurial ventures disappear within the first five years after their establishment (Huyghebaert& Van deGucht, 2016). Ownership is normally highly concentrated in the hands of the entrepreneur and perhaps also some friends and members of his family, who are willing to assume and share risk.

Many studies on SMEs have shown that they are financially constrained and face a financing gap. Cash-flow problems are typically large for SMEs and particularly for the smallest and unquoted among them. From a start-up's capital, firm survival is indeed a key consideration for owners, as they usually hold a largely undiversified portfolio, have pledged personal assets to secure their firm's bank debt, and enjoy sizeable private benefits of control (Kongmanila & Kimbara, 2013).Equity financing comprise of retained profits, own savings, contribution from members, contribution from partners and friends, and cash flows of the business (Memba, 2015). Equity financing is important source of income and have a positive relationship to the performance of the business. Firms that use equity finance are able to make performance better since there is direct control and because equity holders are residual claimant they have to ensure that resources are allocated efficiently (Caroline & Willy, 2015).

Khan (2015) conducted a study on the impact of sources of finance on the performance of SMEs in Pakistan. The study used a case study design and Enterprise Survey Data of 78 SMEs in Pakistan over 3 years. The results showed that the banks play positive role toward the performance of SMEs over the sample period. In contrast, the informal sources negatively influence the performance of SMEs.

Kung'u (2013) studied the factors influencing SMEs access to finance in Westland division. He used a target population of 2870 businesses in the agricultural, entertainment, technology, travel, media and education sectors where he survey 10% of these SMEs to get a sample population of 287 businesses using surveys and interviews. Data was analyzed by both qualitative and quantitative approaches. The data obtained from questionnaire was analyzed using Statistical Package for Social Sciences software (SPSS). The study pointed out that critical to small businesses' success is the availability of financing for both capital acquisition and working capital purposes. Much of this financing takes the form of credit extended by commercial banks and nonbank lenders.

Memba (2015) studied the impact of venture capital finance on the financial performance of SMEs, the target population of this study consisted of 200 SMEs that had used venture capital, the research employed a case study method of utilizing a sample of 100 SMEs that had been financed by venture capitalist in the major towns of Kenya (Nairobi, Kisumu, Nakuru & Mombasa). Data was collected through semi structured questionnaires, Data analysis was carried out using statistical techniques with the help of computer software (SPSS and Excel). Frequency tables were prepared, averages determined, tests of hypothesis like ANOVA, chi-square, correlation analysis were carried out. The study concluded that SMEs that use venture capital experience improved performance. Based on the above findings, the following recommendations were proposed: businesses should be encouraged to use this type of finance for economic development, more local institutions and individuals should be encouraged to join the venture capital fund to build the fund capacity for more investments.

Ruri and Omagwa (2018) studied the relationship between capital structure and financial performance of small and medium enterprises in Embu County, Kenya. The study adopted descriptive design and the target population was 95 SMEs. The study established that equity capital and debt capital have a significant effect on financial performance of the SMEs. Equity capital had greatest proportion in terms of contribution towards capital structure due to its

advantage to the firm. Debt capital was found to be more risky than others while retained earnings proved difficult to raise and maintain.

Mwende *et al.* (2019) examined the effect of equity finance on financial performance of small and medium enterprises in Kenya. The target population of the study was 291,449 licensed SMEs in the selected counties by operational wholesale and retail trade. The study established that the trade credit had the strongest relationship with the financial Performance of SMEs in Kenya, then equity financing, loans and finally informal financing respectively. The study clearly concluded that there is no one source of finance that fully contribute to the financial performance of the SMEs in Kenya.

2.5.3 Interest on Loans and Financial Performance of SMEs

Kimutai (2013) expresses interest rate as the price one pays for using borrowed money or loans. In monetary economies money creates claims because it is an asset, store of value as well as a medium of exchange. Therefore those who lend money expect to be compensated for handing over their claims for the period of the loans to those who borrow money. This interest rate also covers the exposure to credit risk by lenders. Therefore interest rate can be defined as the price lenders expect and borrowers pay for exchanging current claims for greater future claims to goods and services. Interest rates represent the cost of money.

Mwende *et al.* (2019) state that interest rates are important because they control the flow of money in the economy. High interest rates curb inflation but also slow down the economy. Low interest rates stimulate the economy, but could lead to inflation. When interest rates are high, people do not want to take loans out from the bank because it is more difficult to pay the loans back, and the number of purchase of real assets goes down.

The effects of a lower interest rate on the economy are very beneficial for the consumer. Microfinance institutions often finance small loans, particularly in the Third World. These financial institutions usually place an interest rate on loans that may allow the small enterprises to access the loans with ease and at an appropriate time frame and allow them to have sufficient time frame to repay the loan (Kelvin, 2017). In Africa, access to loans and credit facilities has been a major problem for a large portion of South African society (Aryeetey, 2015). The problem is most significant amongst the disadvantaged and especially in rural areas where the majority of people don’t have access to formal banking services due to lack of collateral. The

lack of physical access to banking facilities and the unattractiveness of this large section of society to the banking sector have contributed to millions of unbanked and under-banked South Africans (Wood, 2010).

Nyumba *et al.* (2015) carried out a study to establish the effect of loan interest rate on the performance of small and medium size enterprises in Lurambi Sub-County, Kenya. The study population comprised of all micro-enterprises in Lurambi Sub- County, from which a representative sample of 365 SME owner or managers were selected as respondents. The data for the study was collected by use of questionnaires; Cronbach's Alpha of coefficient test was used to determine the reliability while retest and data triangulation technique was used to determine the validity of the instruments. The study concluded that there exists a statistically significant negative effect of high interest rates on the performance of SMEs in Lurambi Sub-County, Kenya. The findings do not conclusively establish that bank interest policies have negative or positive effects on the performance but recommends reduced interest rates to help good financial performance of SMEs.

Mnang'at *et al.* (2016) carried out a study to examine the effect of risk free rate on micro enterprises in Makutano Township in West Pokot County. The study employed a survey research design to select micro enterprises in West Pokot County and targeted 5 micro enterprises in West Pokot County which comprised of 10 micro enterprise managers and 108 employees hence, the target population of the study comprised of a total of 118 respondents. The study used questionnaires and interview schedule to gather the relevant information under the area of the study and data was analyzed using both qualitative and quantitative techniques. The study results revealed that there was a significant relationship between risk free rate and financial performance. The study recommended that government should empower the SMEs to access and get credits from the commercial banks through formal and informal entrepreneurship education for SMEs to develop their managerial capabilities, accounting skills and overall, be more credit worthy.

Odhiambo (2013) whose main objectives were to determine interest rates influence the demand for credit by SMEs in Kenya and also establish whether interest rates influence the repayment of loans by SMEs in Kenya. The study targeted the 43 banks in Kenya and various sectors under SMEs in Kenya namely; Agriculture, Manufacturing, Building & Construction, Mining, Energy & Water, Trade, Tourism, Hotel & Restaurant, Transport & Communication, Real

Estate and Financial Services. Secondary data was obtained from CBK supervisory report's financial statements and analyzed further. The data covered a period of 5 years from 2008 to 2012. Interpretation of data was done using SPSS and MS Excel. Inferential statistics involving use of ANOVA and regression analysis was done. The study concluded that high interest rates do not necessarily affect the demand for credit. It was observed that high interest rates were not a major concern for SMEs. In this study, SMEs still had a high demand for credit even at annual interest rate of 21.75% in the year 2011 and even a higher demand for credit at an annual interest rate of 18.1%. Those who are willing to pay high interest rates may, on average, be worse risks; they are willing to borrow at high interest rates because they perceive their probability of repaying the loan is low. The researcher therefore concluded that the repayment ability of SMEs is directly affected by changes in interest rates.

2.5.4 Loans Re-Payment Plans and the Performance of SMEs

According to a study by UNDP (2012) found that SMEs in Kenya were able to acquire fixed assets and technologies using MFIs. The study established a positive significant relationship between amount of loan and SMEs achievement of goals. Makokha (2013) revealed that inadequacy of capital hindered the expansion of businesses. The study further found that larger loans enabled micro enterprises graduate to medium enterprises. This argument is supported by Otto *et al.* (2010) in their study that indicated that those SMEs that received large loans frequently had larger labor force than those SMEs that received smaller loans. Appropriate loan sizes for clients matching their needs, realistic interest rates, savings as a prerequisite, regular, short and immediate repayment periods and achieving scale can contribute to the sustainability of SME's enterprises.

Lenders of funds in the formal financial sector use the deposits of their clients while lenders operating in the informal sector use mainly their own funds to advance money to borrowers. In either case, the transactions are expected to lead to recouping the financial capital. If this does not happen, borrowers benefit at the expense of lenders and this continues, bankruptcy will be the eventual result and this will reduce financial intermediation. Kimutai (2013) made it clear that high interest rates lead to adverse selection of loan seekers that affect loan repayment on screening, incentive and enforcement problems. The screening problem is due to the inability of lenders to determine satisfactorily the extent of risk inherent in projects submitted for credit facilities. Empirical evidence indicates that higher loan repayment occurs in Asia as compared

to Africa. High loan repayment performance of 80% to 98% was reported for four successful rural finance institutions in Asia.

According to Sansa (2019), three main factors contributed to the success story of the bank's loans. First, the time of submission of application and disbursement of loans ranged between one and two weeks for the first time borrowers and in the case of repeat borrowers, the period was just about a day. Second, the use of existing social structures or peer groups to ensure prompt payment and thirdly, the rigid structure of loan repayment and routine meetings in which social pressure is applied to achieve prompt payment and the flexible loan repayment terms that were tailored to cash flow patterns from specific income earning activities of lenders. Makundi (2015) conducted a study on the effects of loan repayment on SMEs business performance of Crdb Bank Plc in Tanzania. A cross sectional research design was used in this study. The results showed that individual or borrower specific socio-economic and demographic factors, credit period and high interest rates influence SMEs repayment capacity hence, SMEs fail to repay the loans and at the end become bankrupt. The results also show that banks do formulate strict loans extension procedures so that to make sure that they lessen loans defaults and increase the probability that loans are used as applied in the forms.

Akinyi (2012) carried out a study which sought to determine the effect of flexible loan repayments on the financial performance of SMEs in Nairobi County, Kenya. This research was conducted through a descriptive research design. This study used quantitative, secondary data. The secondary data sources were obtained from the KPMG Top 100 SMEs survey in Kenya over a period of 5 years (2009-2013).Quantitative data was analyzed by descriptive analysis while qualitative data through content analysis. From the findings, the study established that flexible paying plans positively affected the SMEs' financial performance since it enables them to repay their loans flexibly and does not lead to the repossession of assets. The study concludes that there exists a significant positive relationship between flexible paying plans and the financial performance of SMEs based in Nairobi County, Kenya.

Wanjohi and Mugure (2012) in their study revealed the extent entrepreneurs' need for credit among the common and low earning businesses as numerous money lenders in the name of pyramid schemes came up, promising hope among the small investors, which they can make it to the financial freedom through soft borrowing. The reason for opting for these schemes among a good number of entrepreneurs was majorly to seek finances and soft credit with low

interest rates while making profits. Financial constraint remains a major challenge facing SMEs in Kenya.

2.6 Summary of Literature and Knowledge Gaps

Even though different studies have been conducted on financial factors influencing the financial performance of SMEs, most of the studies are limited to sectors/industries, specific institutions and countries. Halim, Jaafar and Akbar (2017) conducted a study on financial related factors affecting the financial performance of Malaysian small and medium enterprises; Popa and Ciobanu (2015) carried out a study on the financial factors that influence the profitability of SMEs in Romania; and Appiah *et al.* (2019) conducted an investigation on the factors that influence the growth of SMEs in Makorla Market, Ghana. However, Halim, Jaafar and Akbar (2017) focused on factors such as inadequacy of finances, lack of financial management skills, and high interest on loans; Popa and Ciobanu (2015) looked ay available tangible assets, access to credit, coverage of interests and total revenues as the main financial factors influencing profitability of SMEs; and Appiah *et al.* (2019) looked at firm size, human resource capacities, management capacities and technological capabilities as the main factors influencing performance of SMEs. In addition, different countries around the world are characterized by different policies and regulatory frameworks on taxation and trade. Therefore, the findings from one country cannot be generalized to another.

In Kenya, Ombongi and Long (2018) studied the factors Affecting Financial Performance of Small and Medium Enterprises in the Manufacturing sector in Kenya; and Nakhaima (2016) examined factors that affect financial performance of small and medium enterprises in Kenya. Nonetheless, Ombongi and Long (2018) on factors such as bank credit, technological cost and employee cost, while Nakhaima (2016) looked at factors like human resource, access to financing and corporate governance. In addition, while Ombongi and Long (2018) study was limited to the manufacturing sector, Nakhaima (2016) was limited to SMEs in Nairobi County. This study therefore sought to examine the effect of access to credit, star-up capital, interest on loans and the loan repayment plans on the financial performance of top 100 SMEs in different parts of the country.

2.7 Conceptual Framework

Bryman (2013) states that conceptual framework is a diagrammatic presentation of the relationship between dependent and independent variables. Figure 2.1 shows the hypothesized

effect of the independent variables on the dependent variable. The independent variables include access to credit, starting capital, loan interest and repayment plans. The dependent variable was the financial performance of small and medium enterprises in Kenya.

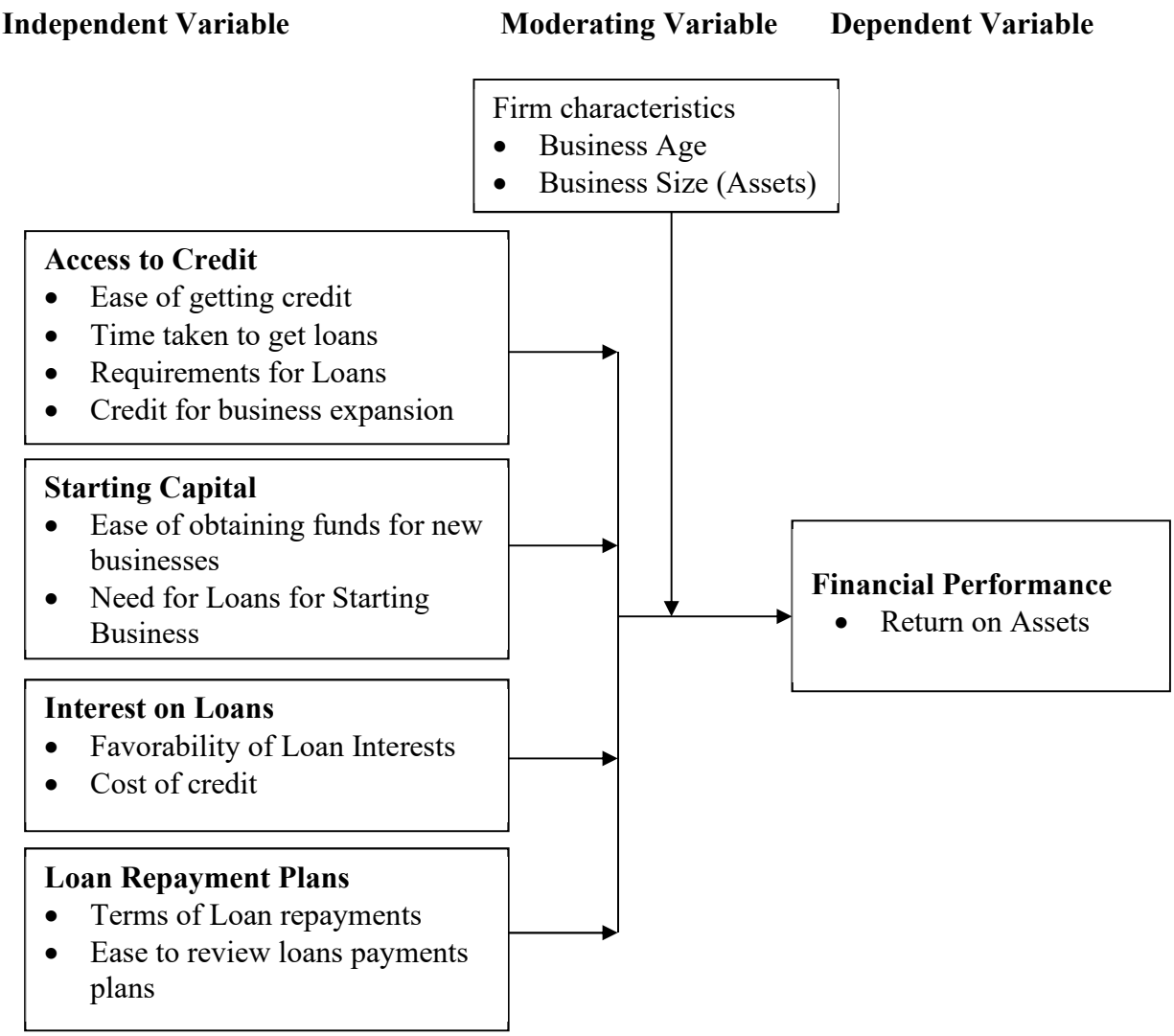

Figure 2.1: Relationship between Financial Factors and Financial Performance

Source: Researcher (2020)

SMEs financing factors will stimulate the small and medium business sector which can be a major catalyst of overall financial performance. SMEs have difficult at times accessing the financial services that can fuel this growth. Figure 2.1 shows five variables. The independent variables are classified into access to credit, start-up capital, interest on loans and loan repayment plans. The dependent variable is financial performance measured in terms return on assets, which is ration of net income to total assets. The factors researched on were all financing

related factors as the main being accessibility to finance followed by other factors that would always be present at any given time credit is sourced which include, getting capital for a new business, interest on loans, and the process of repayments of those loans.

Firm characteristics determines how firms perform, bigger companies can be able to survive during times of crises than small companies due to reserves they might have accumulated (Ooghe & Prijcker, 2015). There is also theoretical evidence as well as empirical facts that demonstrate that the return rate of a company increases as the size of its assets increase. This could imply that a firm with a high asset value would have a lower risk of poor financial performance in comparison to middle or small company even when both show the same financial ratios values. The maturity of a company may influence the financial stability of a company. According to Ooghe and Prijcker (2015), a young company has to build up external authenticity and stable relationship with stakeholders. They are therefore, very vulnerable. Companies in different industries, even with a similar financial profile, have a different probability of achieving high financial success.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This chapter gives the methodology that was used in response to the research questions in this study. It includes the research design, target population, sample size and sampling technique, pilot study, research instruments, the data collection procedure, data analysis techniques and ethical considerations.

3.2 Research Design

The study adopted explanatory research design to show the effect of accesses to credit, starting capital, interests on loans and loans re-paying plans on the financial performance of SMEs in Kenya. Explanatory research design is used to identify the extent and nature of cause and effect relationship among variables in a study. Furthermore, explanatory research can be carried out so as to examine effects of particular changes on several processes and present norms and traditions (Singpurwalla, 2013). Explanatory research will be adopted in this study as it emphasizes on analysis of a particular situation to describe the patterns of correlation and associations between the variables (Beach & Rasmus, 2016). In addition, the study will make use of an explanatory research design as it indicates that a causal effect occurs when variation in one phenomenon, an independent variable, leads to or results, on average, in variation in another phenomenon, the dependent variable.

3.3 Target Population

According to Kothari (2012), population is a well-defined set of people, elements, services and events, a group of things or households which are being studied. Ullah and Ameen (2018) indicates that population refers to the whole group of items under study in a given field of research and always have similar characteristics. The population was 100 top SMEs in Kenya. The study targets all 100 heads of finance departments of the SME's published by the Ministry of Industrialization, Trade and Enterprise Development in the year 2018. Therefore, the target population of the study was heads of finance departments in the 100 top SMEs in Kenya.

3.4 Sample Size and Sampling Techniques

A sample size must be large enough to be representative of the universe population (Kothari, 2012). Creswell (2014) stresses that sample size chosen by the researcher should be capable of giving enough information about the population and one which can be analyzed with ease.

Yamane's formula was adopted in this study to determine the sample size (Yamane, 1973). The formula was adopted because it puts into consideration the population and confidence interval.

$$n = \frac{N}{1 + NE^2}$$

Where by:

n = Sample Size

N = target population

E = margin of error (0.05)

$$n = \frac{100}{1 + (100 * 0.05^2)}$$

$$n = 80$$

Table 3.1: Sample Size

Category	Target Population	Sample Size
Supply and Logistics	36	29
Automobile	8	6
Construction	10	8
Health	4	3
Hospitality	4	3
ICT	12	10
Manufacturing	17	14
Financial	2	2
Others (agriculture, training, cleaning and security)	7	6
Total	**100**	**80**

Source: Ministry of Industrialization, Trade and Enterprise Development (2018)

The study used stratified random sampling technique to select 80 SMEs from the target population of 100. Stratified random sampling produces estimates of overall population parameters with greater precision and ensures a more representative sample is derived from a relatively homogenous population (Bryman, 2013). The strata included supply and logistics, automobile, construction, health, hospitality, ICT, manufacturing, financial and others (agriculture, training, cleaning and security). Stratified random sampling was considered appropriate since it gave every respondent in the target population an equal chance of being

selected as a study respondent and thus it had no bias and eased generalization of the gathered findings. Simple random sampling was then used to select the population from each stratum. The study used proportionate stratification to ensure that the sample size of each stratum is proportionate to the population size of the stratum. This means that each stratum has the same sampling fraction. The formula is;

$$n_h = (N_h / N) * n$$

Where n_h is the sample size for stratum *h*, N_h is the population size for stratum *h*, N is the total population size, and n is total sample size.

3.5 Research Instruments

This study used primary data, which was collected by use of structured questionnaires from the heads of finance departments in the selected SMEs. Questionnaires are commonly used for cases where the respondents willingly cooperated and were within reach. This kind of data collection method was convenient as it was used to reach many people provided such persons could independently read and write. Bryman and Cramer (2012) noted that the specific objectives of the study and the problem of study can be easily defined using questionnaires. In addition the questionnaires were preferred in this study because they are very economical in terms of time, energy and finances. The structured questions were used as they conserve energy, money and time and facilitate an easier analysis as they are in immediate usable form. The questionnaire comprised of four sections. The first section contained questions on demographic information. The second section contained questions on the four independent variables, the third section comprise of questions on the moderating variable and the six section comprised of questions on the dependent variable (financial performance of SMEs). In section two and three a five point Likert Scale was used where 1 represented Strongly Disagree, 2 represented Disagree, 3 represented Neutral, 4 represented Agree, and 5 represented Strongly Agree.

3.6 Pilot Study

A pretest was conducted in an effort to identify and rephrase any ambiguous, misinterpreted or misunderstood questions. In addition, the pretest facilitates the removal of typographical errors and determination of whether the questions asked were relevant and appropriate (Collis & Hussey, 2014). The pretest was conducted in the firms located in industrial area region Nairobi. This region was chosen due to its proximity to the study area. A pilot study was embraced to pretest data collection instruments for validity and reliability. According to Creswell (2014), a

pilot study is important for testing the validity and reliability of data collection instruments. Pilot study was done using 8 heads of departments in SMEs based in industrial area region Nairobi. According to Sahu (2013) 10% of the sample required for a full study should be used in a sample size.

3.6.1 Validity of the Research Instrument

Validity as explained by Russell (2013) is the degree to which the measurement instrument or approach is successful in quantifying or describing the element under measure. Validity is important to determine the precision of the estimation scales with a specific objective to evaluate the degree to which proposed constructs have been captured, that is, to examine the validity of the instrument. Face validity and content validity, are the two types validity commonly used. Face validity was used in this study to assess whether the questions which were posed were misinterpreted or misunderstood. The use of pretesting decreases face validity. Content or logical validity is the degree to which the used measure represents all the facets of the provided social construct (Gorard, 2013). This study improved content validity by consulting individuals such as the supervisors who are experts in the current area of study. Additionally, face validity of the research was improved by use of the pretest and making clear all the ambiguous and unclear questions.

3.6.2 Reliability of the Research Instrument

According to Leedy and Ormrod (2014), instrument reliability demonstrates the internal consistency of things representing a hidden make. It alludes to the degree to which instruments are reliably measuring what they should quantify. The reliability of the data and findings is one of the main prerequisites of any research procedure. Internal consistency coefficient gives the reliability of measurement estimate by assuming that items that measure similar constructs are supposed to correlate. Cronbach's alpha is the most frequently used method for measuring internal consistency. Reliability in this method increases with the value of Cronbach's alpha where the alpha values used are between 0 and 1. Gorard (2013) indicates that a correlation coefficient of ranging between 0.7 and 0.8 is considered as acceptable reliability value. Therefore, in this study a Cronbach's alpha of 0.7 was considered acceptable.

According to the findings, access to credit had a Cronbach's reliability alpha of 0.811, starting capital had a Cronbach's reliability alpha of 0.820, interest on loans had a Cronbach's reliability alpha of 0.721, loan repayment plans had a Cronbach's reliability alpha of 0.852.

This clearly shows that the research instrument was reliable and hence no amendments were needed.

Table 3.2: Cronbach's Reliability Alpha

Construct	Cronbach's reliability alpha
Access to Credit	0.811
Starting Capital	0.820
Interest on loans	0.721
Loan repayment plans	0.852
Average	**0.801**

3.7 Data Collection Procedure

Prior to data collection exercise, the researcher obtained a data collection letter from the university. This took place after the proposal was defended and submitted to the department of department of accounting, finance and management science. The letter assisted in applying for research permit from NACOSTI. The respondents also received a transmittal letter for data collection from the researcher. The questionnaires were delivered by hand as well through emails to the respondents with aim to increase the response rate. The respondents and gave them an allowance of two weeks to complete filling the questionnaire after which he collected the duly filled questionnaires. The research ensured a daily follow up to check on the progress of the data collection exercise. The data collection process took three weeks.

3.8 Data Analysis and Presentation

Data was analyzed by use of both inferential and descriptive statistics with the help of statistical software known as Statistical Package for Social Sciences (SPSS version 22). Descriptive statistics was used to summarize the background information. Descriptive statistics composed of calculation of percentages, and frequencies, measures of central tendency (mean) measures of dispersion (standard deviation). The results were presented using tables and figures which included bar charts and pie charts.

The relationship between the independent variable(s) and the dependent variable was determined through the use of correlation analysis and regression analysis. The study used simple and multiple regression analysis to test hypothesis. The study applied a 95% confidence interval and hence the significance level of 0.05. This implied that for an independent variable

to have a significant influence on the dependent variable, the p-value ought to be below the significance level (0.05).

3.8.1 Model Specification

The first objective of the study was to establish the effect of access to credit on the financial performance of SMEs in Kenya. The simple linear regression model for access to credit was specified as;

$Y = \beta_0 + \beta_1 X_1 + \varepsilon$ ……3.1

Whereby;

Y = Financial performance

B_0 = Constant

β_1 =Coefficients of determination

X_1 = Access to credit

ε = Error term

The second objective of the study was to establish the effect of starting capital on the financial performance of SMEs in Kenya. The simple linear regression model for access to credit was specified as;

$Y = \beta_0 + \beta_2 X_2 + \varepsilon$ ……3.2

Whereby;

Y = Financial performance

B_0 = Constant

B_2 =Coefficients of determination

X_2 = Starting capital

ε = Error term

The third objective of the study was to establish the effect of starting capital on the financial performance of SMEs in Kenya. The simple linear regression model for access to credit was specified as;

$Y = \beta_0 + \beta_3 X_3 + \varepsilon$ ……3.3

Whereby;

Y = Financial performance

B_0 = Constant

B_3 =Coefficients of determination

X_3 = Interest on loans

ε = Error term

The fourth objective of the study was to establish the effect of loan re-paying plans on the financial performance of SMEs in Kenya. The simple linear regression model for access to credit was specified as;

$Y = \beta_0 + \beta_4 X_4 + \varepsilon$ 3.4

Whereby;

Y = Financial performance

B_0 = Constant

B_4 =Coefficients of determination

X_4 = Loan re-paying plans

ε = Error term

The fifth objective of the study was to examine the effect of the combined access to credit, capital, loan interest and re-payment plans collectively on the financial performance of SME's in Kenya. Since there are four independent variables in this study the multiple regression model was as follows:

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$ 3.5

Whereby;

Y = Financial performance

B_0 = Constant

β_1- β_4 =Coefficients of determination

X_1 = Access to credit

X_2 = Star-up capital

X_3 = Interest on loans

X_4 = Loan repayment plans

ε = Error term

3.9 Diagnostic Tests

Diagnostic tests were carried out to test the key regression assumptions, which include normality, multicollinearity and auto-correlation.

3.9.1 Multicolinearity Test

Multicolinearity in regression is a condition that occurs when some predictor variables in the model are correlated with other predictor variables**.** One variable can be predicted from the other with some degree of accuracy (Leedy & Ormrod (2014). In Perfect multicolinearity, the predictor is singular and cannot be inverted. Multicollinearity was tested in this study using tolerance and VIF. The tolerance measures the influence of one independent variable on all other independent variables; the tolerance is calculated with an initial linear regression analysis. With VIF > 10 there is an indication for multicollinearity to be present; with VIF > 100 there is certainly multicollinearity in the sample.

3.9.2 Autocorrelation Test

A linear regression analysis requires that there is little or no autocorrelation in the data. One Autocorrelation in linear regression model can be tested using Durbin-Watson test (Singpurwalla, 2013). Durbin-Watson's d tests the null hypothesis that the residuals are not linearly auto-correlated. While d can assume values between 0 and 4, values around 2 indicate no autocorrelation. As a rule of thumb values of $1.5 < d < 2.5$ show that there is no auto-correlation in the data, however the Durbin-Watson test only analyses linear autocorrelation and only between direct neighbors, which are first order effects.

3.9.3 Shapiro Wilk test

To fulfill the requirement of normal distribution, Shapiro Wilk test was used to investigate whether the variables are normally distributed or not (Saunders, Lewis & Thornhill, 2012). The null-hypothesis of this test is that the population is normally distributed; thus, if the p-value is less than the chosen alpha level, then the null hypothesis is rejected and there is evidence that the data tested is not from a normally distributed population; in other words, the data is not normal.

3.7 Measurement of Research Variables

All research variables were measured as shown in Table 3.1.

Table 3.3: Measurement of Research Variables

Variable	Operational definition	Measurement
Financial performance	The firm's ability to continue in operation through making profits	• Return on Assets=Net profit after tax/total assets
Access to credit	This refers to the availability of cash for the daily operations of the company	• Ease of getting credit • Time taken to get loans • Requirements for Loans • Credit for business expansion
Starting capital	This is a financial resource in the form of money required as seed capital in the formative stages of the firm	• Ease of obtaining funds for new businesses • Need for Loans for Starting Business
Interest on loans	This is the percentage of the principal charged by the lender for the use of its money	• Favorability of Loan Interests • Cost of credit
Loan repayment plans	This refers to favorable arrangement between the lender and the borrower on the terms of repayment and especially during unfavorable economic times which provide for further negotiation plans to suit the borrowers' liquidity	• Terms of Loan repayments • Ease to review loans payments plans

Source: Author and Literature Review (2020)

3.10 Ethical Issues

Permit for data collection was requested from National Commission for Science, Technology and Innovation (NACOSTI) and the Egerton University. Furthermore, human dignity will be ensured together with observation of all other principles relating the acceptable code of conduct in any business. Information consent involves understanding and voluntary agreement to take part in a research project (Kara, 2015). The research put into consideration the principle of sensitivity through allowing only the interested participants to participate in the research.

To ensure confidentiality, the respondents were assured that integrity and confidentiality of the data will be upheld during the research process. They were also assured that the research will be used exclusively for learning purpose. The collected data was locked in a safe place to ensure that only the authorized gains access of the data. In ensuring anonymity, a research instrument did not collect identifying information of the respondents save for when it is important to the protocol of a study. The participants were requested not to indicate their personal contacts or their names when filling the questionnaires to be used in this study.

CHAPTER FOUR
RESULTS AND DISCUSSIONS

4.1 Introduction

The chapter presents the response rate, analysis of data, interpretation of the findings as per the objective of this study. The study sought to determine the influence of factors affecting the financial performance of SMEs in Kenya. Specifically, the study sought to determine the effect of access to credit, start-up capital, interest on loans and loan repayments plans on the financial Performance. The results of this study were present in tables and figures.

4.2 Response Rate

The sample size of the study was 80 heads of finance departments in top SMEs in Kenya. Out of 80 questionnaires that were distributed, 65 were duly filled and returned giving a response rate of 81.25%. According to Nulty (2011), a response rate of 75 per cent is adequate for analysis, for making conclusions and making inferences about a population. In addition, Fincham (2013) indicates that a response rate of 60% and above is acceptable for analysis. This implies that the response rate of 81.25% was adequate for analysis, drawing conclusions and reporting.

4.3 Demographic Information

The respondents' demographic information comprised of their position in their respective organizations, gender, age and highest level of education as well as their duration in the organization.

4.3.1 Gender of the Respondents

The respondents were requested to indicate their gender. The results were as presented in Figure 4.1. From the findings, 53.2% of the respondents indicated that they were female while 46.8% indicated that they were male. This implies that majority of the heads of finance departments in top 100 SMEs in Kenya are female.

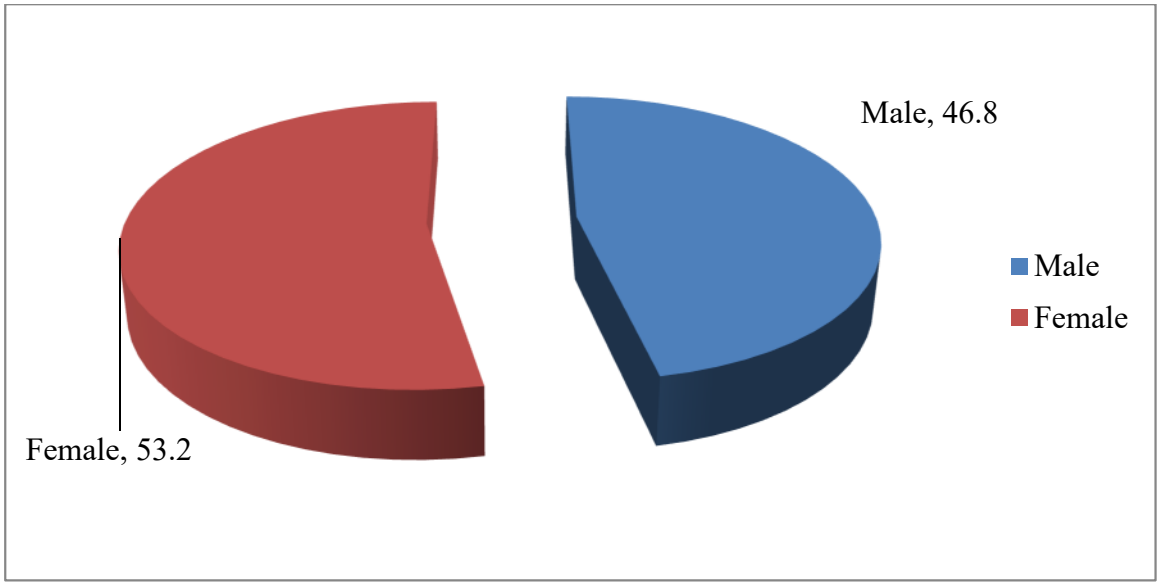

Figure 4.1: Gender of the Respondents

4.3.2 Duration in the Organization

The respondents were further asked to indicate the duration of time they had been working in their organization. The results were as presented in Figure 4.3. According to the findings, 35.4% of the respondents indicated that they had been working in their organizations for between 3 and 5 years, 33.8% indicated for between 6 and 10 years, 18.5% indicated for more than 10 years and 12.3% indicated for less than 2 years. These findings imply that most of the heads of finance departments in top 100 SMEs in Kenya had been working in their organizations for between 3 and 5 years.

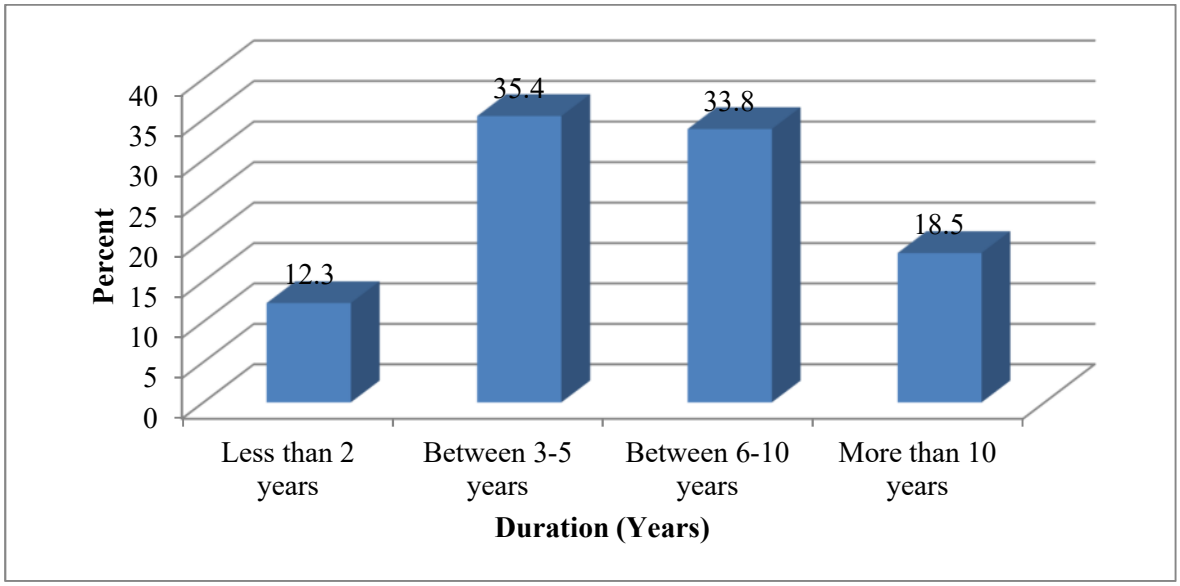

Figure 4.2: Duration in the Organization

4.3.3 Respondents' Highest Level of Education

The respondents were also asked to indicate their highest level of education and the results were as shown in Figure 4.4. According to the findings, 53.9% of the respondents indicated that they had bachelors' degrees, 24.6% had diplomas and 21.5% indicated that they had masters' degrees. These findings show that most of the heads of finance departments in top 100 SMEs in Kenya had bachelors' degrees as their highest level of education.

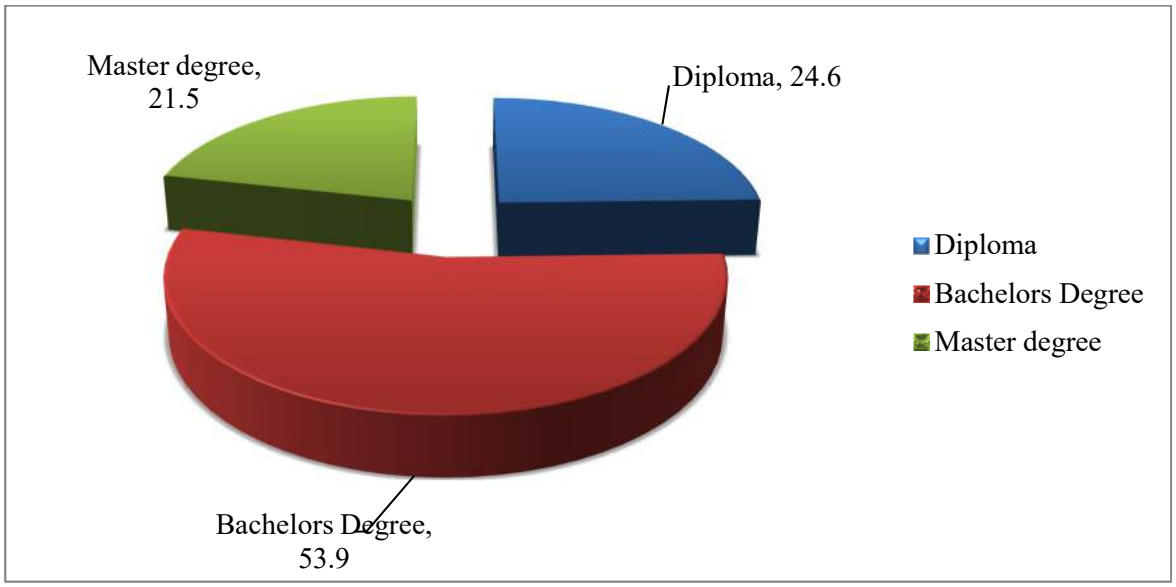

Figure 4.3: Respondents' Highest Level of Education

4.4 Diagnostic Tests

Diagnostic tests were carried out to test the key regression assumptions, which include normality, multicollinearity and auto-correlation. Shapiro-Wilk test was used to test the normality of data. Null hypothesis in Shapiro–Wilk test indicate that variables data are obtained from a normally distributed population. According to the findings, as shown in Table 4.1 the respective p-values were: access to credit (p-value=0.061), start-up capital (p-value=0.115), interest on loans (p-value=0.097), loan repayments plans (p-value=0.101), external environment (p-value=0.064) and financial performance (p-value=0.079). All the p-values are above the predetermined p-value significance threshold of 0.05 and therefore we do not reject the null hypothesis that the sample data were obtained from a normally distributed population. This implies that the data for all the variables were normally distributed.

Table 4.1: Tests of Normality

	Statistic	df	Sig.
Access to credit	.969	65	.061
Start-up capital	.987	65	.115
Interest on loans	.981	65	.097
Loan repayments plans	.985	65	.101
Financial Performance	.979	65	.079

Durbin–Watson statistic was used to test autocorrelation. Durbin–The general principle in Durbin–Watson statistic is that values which range from 1.5 to 2.5 tend to indicate there is non-autocorrelation in a particular data. The results for Durbin-Watson test were as shown in Table 4.2 below. The value of Durbin–Watson statistic in this study was 1.869. Since the value is within the range of 1.5 to 2.5, it denotes that the data does not auto correlate. Therefore, there is no serial auto correlation in the data.

Table 4.2: Autocorrelation Test

Model	Durbin-Watson
1	1.869

The study adopted the use of Variance Inflation Factor (VIF) so as to measure multicollinearity among the variables. The general principle is that VIF which is greater than ten (10) tend to warrant further investigation. The VIF, as shown in Table 4.3, indicates that multicollinearity was absent among the independent variables, since the VIF values were below 6 which is the acceptable threshold below which indicates absence of multicollinearity. Access to credit had a VIF of 1.316, Start-up capital had a VIF of 1.623, Interest on loans had a VIF of 1.488 and Loan repayments plans had a VIF of 1.472. This implies that the independent variables are not highly correlated among themselves.

Table 4.3: Collinearity Statistics

	Tolerance	VIF
Access to credit	.760	1.316
Start-up capital	.616	1.623
Interest on loans	.672	1.488
Loan repayments plans	.680	1.472

4.5 Descriptive Statistics

Descriptive statistic was used to present how the participants responded to questions relating to selected financial factors and financial performance of SMEs. A five point Likert scale was used in rating how access to credit, starting capital, interest on loans and repayments plans influence the financial performance of SMEs. Where by 1, strongly disagree, 2 Disagree, 3 Moderate Agree, 4, Agree and 5 strongly agree.

4.5.1 Access to Credit

The respondents were requested to indicate their level of agreement on the various statements on the access to credit in their organizations. As indicated in Table 4.4, the respondents agreed with a mean of 4.384 and a standard deviation of 0.629 that financial institutions take a lot of time to approve loans applied by SME. The respondents also agreed with a mean of 4.353 and a standard deviation of 0.570 that loan application takes less time when firms have audited financial documents. Also, the respondents agreed with a mean of 4.232 and a standard deviation of 0.723 that their organizations have severally applied for business expansion loans and all applications have been approved. Further, they agreed with a mean of 4.231 and a standard deviation of 0.765 that credit for business expansion is easily approved by financial institutions.

With a mean of 4.122 and a standard deviation of 0.580 the respondents agreed wit the statement indicating that not all SME are granted credit for business expansion. The respondents agreed with a mean of 4.076 and a standard deviation of 1.004 that most SMEs lack audited financial statements hence find it hard to access credit facilities. As shown by a mean of 3.984 and a standard deviation of 0.717 the respondents agreed that financial institutions demand a lot of collaterals to approve loans applied by SME. The respondents also agreed with a mean of 3.892 and a standard deviation of 0.589 that audited financial statements are required for loan application by the SMEs.

However, the respondents disagreed with the statement indicating that they always access credit facilities without much restriction as shown by a mean of 2.415 and a standard deviation of 1.445. They also disagreed with the statement indicating that SMEs find it easy to access to credit facilities from financial institutions as shown by a mean of 2.323 and a standard deviation of 1.174. The respondents disagreed with the statement indicating that the time taken between

loan application and loan approval is very short as shown by a mean of 2.261 and a standard deviation 1.337.

Table 4.4: Access to Credit

	N	Min	Max	Mean	Std. Deviation
SME find it easy to access to credit facilities from financial institutions	65	1.00	5.00	2.323	1.174
We always access credit facilities without much restrictions	65	1.00	5.00	2.415	1.445
Most SMEs lack audited financial statements hence find it hard to access credit facilities	65	1.00	5.00	4.076	1.004
The time taken between loan application and loan approval is very short	65	1.00	5.00	2.261	1.337
Financial institutions take a lot of time to approve loans applied by SME	65	3.00	5.00	4.384	.629
loan application takes less time when firms have audited financial documents	65	3.00	5.00	4.353	.570
Financial institutions demand a lot of collaterals to approve loans applied by SME	65	3.00	5.00	3.984	.717
Audited financial statements are required for loan application by the SME	65	3.00	5.00	3.892	.589
Credit for business expansion is easily approved by financial institutions	65	3.00	5.00	4.231	.765
Not all SME are granted credit for business expansion	65	3.00	5.00	4.122	.580
We have severally applied for business expansion loans and all applications have been approved	65	3.00	5.00	4.232	.723
Aggregate	**65**			**3.661**	**0.867**

4.5.2 Starting Capital

The respondents were requested to indicate their level of agreement on the various statements on starting capital among SMEs. As indicated in Table 4.5, the respondents agreed with a mean of 4.323 and a standard deviation of 0.615 that there are many source of funds for new businesses. In addition, they agreed with a mean of 4.307 and a standard deviation of 0.465

that entrepreneurs find it hard to offer obtain funds for new business. With a mean of 4.169 and a standard deviation of 0.651 the respondents agreed with the statement indicating that financial resources need collaterals to approve loans for business start-ups. Also, the respondents agreed with a mean of 4.138 and a standard deviation of 0.726 that securing funds for new business is hard as compared to securing funds for boosting business.

The respondents agreed with a mean of 4.476 and a standard deviation of 0.640 that financial institutions are the best options for getting loans for starting business. With a mean of 4.353 and a standard deviation of 0.623 the respondents agreed that loan facilities for starting new business need collateral for approval. The respondents agreed with a mean of 4.292 and a standard deviation of 0.654 that not all SMEs get loans for their business from banking institutions. In addition, the respondents agreed with a mean of 4.261 and a standard deviation of 0.593 that most SMEs depend on loan facilities to start their business. With a mean of 2.753 and a standard deviation 1.159 the respondents were neutral on the statement indicating that bank loans are very demanding therefore SMEs try to access loans from SACCOs.

Table 4.5: Starting Capital

	N	Min	Max	Mean	Std. Deviation
Securing funds for new business is hard as compared to securing funds for boosting business	65	3.00	5.00	4.138	.726
Financial resources need collaterals to approve loans for business start-ups	65	3.00	5.00	4.169	.651
entrepreneurs find it hard to offer obtain funds for new business	65	4.00	5.00	4.307	.465
There are many source of funds for new businesses	65	3.00	5.00	4.323	.615
Most SMEs depend on loan facilities to start their business	65	3.00	5.00	4.261	.593
Loan facilities for starting new business need collateral for approval	65	3.00	5.00	4.353	.623
Financial institutions are the best options for getting loans for starting business	65	3.00	5.00	4.476	.640
Not all SME get loans for their business from banking institutions	65	3.00	5.00	4.292	.654
Bank loans are very demanding therefore SMEs try to access loans from SACCOs	65	1.00	5.00	2.753	1.159
Average				**4.119**	**0.681**

4.5.3 Interest on Loans

The respondents were asked to indicate their level of agreement on the various statements on Interest on Loans among SMEs. From the findings, as shown by Table 4.6, respondents agreed with a mean of 4.446 and a standard deviation of 0.638 that apart from the charged interest there are other loan processing charges that make the cost of credit facilities very high. In addition, the respondents agreed with a mean of 4.323 and standard deviation of 0.885 that they were not satisfied with the cost of credit facilities charged by the financial institutions. Further, the respondents agreed with a mean of 4.422 and a standard deviation of 0.531 that most SMEs have no option but to go for the costly loans offered by the financial institutions. Further, they agreed with a mean of 4.169 and a standard deviation of 0.601 that the interest on loan charged by the financial institutions is very high.

With a mean of 4.092 and a standard deviation of 0.744 the respondents agreed that the cost of accessing credit facilities is very high. In addition, they agreed with a mean of 4.076 and a standard deviation of 1.065 that some SMEs find it hard to service the applied loans due to high interest rates. Further, they agreed with a mean of 3.953 and a standard deviation of 1.037 that SMEs are termed as risk borrowers. The reasons why financial institutions charged very high cost. The respondents were neutral on the statement indicating that their institutions find it hard to manage loan repayment due to the high cost on the loans as shown by a mean of 2.692 and a standard deviation of 1.249. They were also neural with the statement indicating that their organizations find the interest charged on loans very favorable as shown by a mean of 2.562 and a standard deviation of 1.446. The respondents disagreed with the statement indicating that they were satisfied with the amount of interest charged on loans by the financial institutions as shown by a mean of 2.138 and a standard deviation of 1.309.

Table 4.6: Interest on Loans

	N	Min	Max	Mean	Std. Deviation
The interest on loan charged by the financial institutions is very high	65	3.00	5.00	4.169	.601
Some SMEs find it hard to service the applied loans due to high interest rates	65	1.00	5.00	4.076	1.065
Our organizations finds the interest charged on loans very favorable	65	1.00	5.00	2.562	1.446
We are satisfied with the amount of interest charged on loans by the financial institutions	65	1.00	5.00	2.138	1.309
The cost of accessing credit facilities is very high	65	2.00	5.00	4.092	.744
Apart from the charged interest there are other loan processing charged that makes the cost of credit facilities very high	65	3.00	5.00	4.446	.638
I am not satisfied with the cost of credit facilities charged by the financial institutions	65	1.00	5.00	4.323	.885
Most SMEs have no option but to go for the costly loans offered by the financial institutions	65	3.00	5.00	4.446	.531
SMEs are termed as risk borrowers that is why financial institutions charged very high cost	65	1.00	5.00	3.953	1.037
Our institution finds it hard to manage loan repayment due to the high cost on the loans	65	1.00	5.00	2.692	1.249
Average	**65**			**3.690**	**0.951**

4.5.4 Loan Re-Payment Plans

The respondents were requested to indicate their level of agreement on the various statements on loan repayment plans among SMEs. From the findings, as shown in Table 4.7, the respondents agreed with a mean of 4.461 and a standard deviation of 0.731 that the loan review process in financial institutions takes a lot of time. In addition, the respondents agreed with a mean of 4.456 and a standard deviation of 0.502 that their firms always repay its loans in time. Also, the respondents agreed with a mean of 4.246 and a standard deviation of 0.811 that loan repayment plans are very lengthy hence not regularly reviewed.

With a mean of 4.076 and a standard deviation of 0.941 the respondents agreed that financial institution give enough time for loan repayment. In addition, they agreed with a mean of 3.184 and a standard deviation of 1.297 that the process of reviewing the loan repayment plans is very complicated. They were neutral on the statement indicating that they were satisfied with the loan repayment terms from the financial institutions as shown by a mean of 2.631 and a standard deviation of 1.329. The respondents were neutral on the statement indicating that SMEs find it easy to repay the applied loans due to favorable repayment terms as shown by a mean of 2.569 and standard deviation of 1.185. They were also neutral on the statement indicating that the loan repayment plans are regularly reviewed as shown by a mean of 2.507 and a standard deviation of 1.213. The respondents disagreed with the statement indicating that the terms on loan repayment are favorable for SMEs as shown by a mean of 2.107 and a standard deviation of 0.970.

Table 4.7: Loan Re-Payment Plans

	3	**4**	**5**	**Mean**	**Std. Deviation**
The terms on loan repayment are favorable for SMEs	65	1.00	4.00	2.107	.970
SMEs find it easy to repay the applied loans due to favorable repayment terms	65	1.00	5.00	2.569	1.185
Financial institution give enough time for loan repayment	65	1.00	5.00	4.076	.941
I am satisfied with the loan repayment terms from the financial institutions	65	1.00	5.00	2.631	1.329
Our organization always repay its loans in time	65	4.00	5.00	4.461	.502
The loan repayment plans are regularly reviewed	65	1.00	5.00	2.507	1.213
The process of reviewing the loan repayment plans is very complicated	65	1.00	5.00	3.184	1.297
The loan review process takes a lot of time	65	1.00	4.00	4.461	.731
Loan repayment plans are very lengthy hence not regularly reviewed	65	1.00	5.00	4.246	.811
Average	**65**			**3.360**	**0.998**

4.5.5 Financial Performance

The financial performance of small and medium enterprises was measured in terms of profitability and total assets in the small and medium enterprises. The respondents were requested to indicate the total assets in the SMEs. From the results, 44.62% of the respondents indicated that the total assets in their SMEs were between Ksh. 601 million and Ksh. 900 million, 26.15% indicated between Ksh. 301 million and Ksh. 600 million, 13.85% indicated between Ksh. 901 million and KSh. 1.2 billion, 9.23% indicated below Ksh. 300 million, and 6.15% indicated above Ksh. 1.2 billion. This shows that most the SMEs had total assets between Ksh. 601 million and Ksh. 900 million.

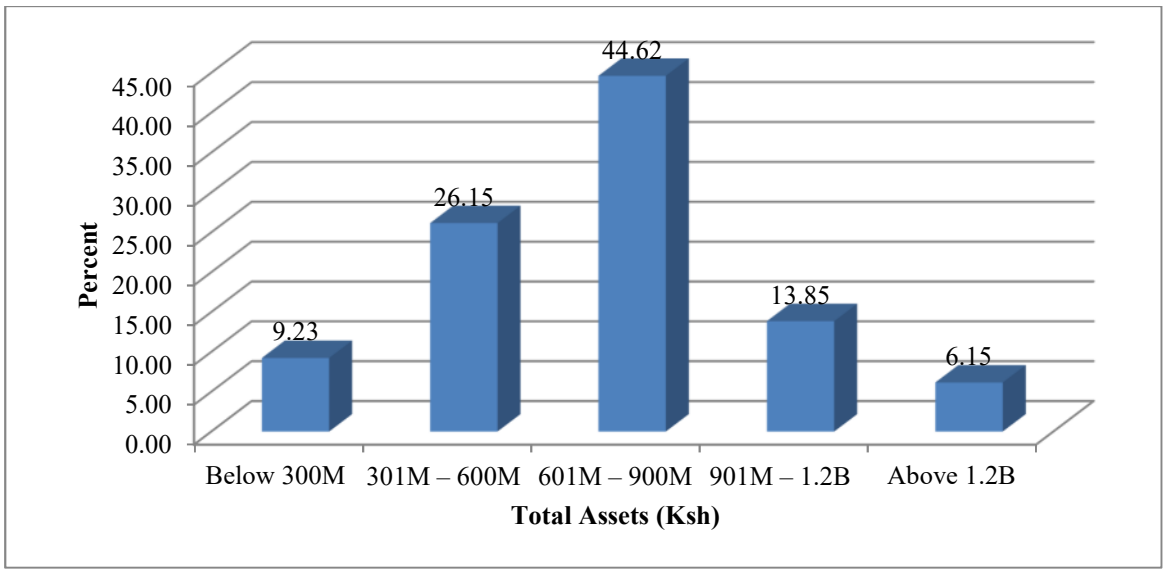

Figure 4.4: Total Assets in SMEs

The respondents were also requested to indicate the profitability of their SMEs. From the findings, 32.21% of the respondents indicated that the profitability of their businesses was between Ksh. 201 million and Ksh. 300 million, 26.15% indicated between Ksh. 101 million and Ksh. 200 million, 18.46% indicated between Ksh,. 301 million and Ksh. 400 million, 12.31% indicated below Ksh. 100 million and 10.77% indicated above Ksh. 400 million. This shows that the profitability of the 100 top SMEs in Kenya ranges between Ksh. 201 million and Ksh. 300 million.

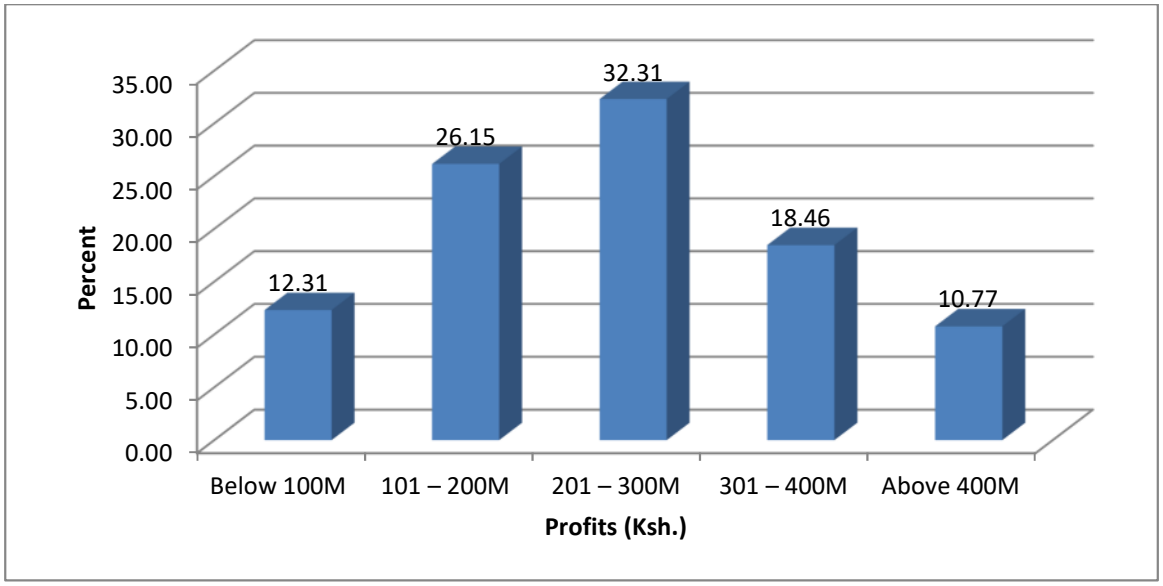

Figure 4.5: Profitability of SMEs

4.6 Inferential Statistics

The study used inferential statistics such as correlation analysis, simple regression and multiple regression analysis to determine the association between the independent variables and the dependent variable. For the purpose of inferential analysis, ROA was converted into five point likert scale form such that a ratio less than 0.1=1, greater than 0.1 but less than 0.2= 2, greater than 0.2 but less than 0.3= 3, greater than 0.3 but less than 0.4 = 4 while ROA above 0.4 = 5.

4.6.1 Correlation Analysis

The study used Pearson product moment correlation to quantify the degree in which the independent variables (access to credit, start-up capital, interest on loans and loan repayments plans) and the dependent variable (financial performance). The results were as presented in Table 4.8.

Table 4.8: Correlation Coefficients

		Financial Performance	Access to Credit	Starting capital	Interest on Loans	Loan Repayment Plans
Financial Performance	Pearson Correlation	1				
	Sig. (2-tailed)	.000				
	N	65				
Access to Credit	Pearson Correlation	.890**	1			
	Sig. (2-tailed)	.000				
	N	65	65			
Starting capital	Pearson Correlation	.869**	.169	1		
	Sig. (2-tailed)	.000	.176			
	N	65	65	65		
Interest on Loans	Pearson Correlation	-.886**	.278	.128	1	
	Sig. (2-tailed)	.000	.109	.184		
	N	65	65	65	65	
Loan Repayment Plans	Pearson Correlation	.887**	.288	.121	.117	1
	Sig. (2-tailed)	.000	.087	.192	.201	
	N	65	65	65	65	65

From the correlation analysis results in Table 4.8, access to credit and financial performance of small and medium enterprises in Kenya had a strong, positive significant correlation as shown by a correlation coefficient of ($r= 0.890$, $p<0.05$), starting capital and financial performance of small and medium enterprises in Kenya had a strong, positive significant correlation as shown by a correlation coefficient of ($r= 0.869$, $p<0.05$), interest on loans and financial performance of small and medium enterprises in Kenya had a strong, negative significant correlation as shown by a correlation coefficient of ($r= -0.886$, $p<0.05$), and loan repayment plans and financial performance of small and medium enterprises in Kenya has a strong, positive significant correlation as shown by a correlation coefficient of ($r= 0.887$, $p<0.05$).

From these findings, the study finds that access to credit, starting capital, loan repayment plans and financial performance were positive and significantly correlated. However, Interest on Loans and financial performance were negatively correlated. These findings agree with Mwangi (2014) findings that access to credit influences the financial growth of SMEs. These findings also concur with Ruri and Omagwa (2018) findings that capital has a significant effect on financial performance of the SMEs. The findings are in line with Nyumba *et al*. (2015) findings that there exists a statistically significant negative effect of high interest rates on the performance of SMEs in Lurambi Sub-County, Kenya. These findings also concur with Makundi (2015) loan repayment plans had a significant effect on financial performance of SMEs.

4.6.2 Hypothesis Testing

The study used both simple and multiple linear regression analysis to determine the effect of selected financial factors on the financial performance of SMEs. Fitness of the model decision was based on F-statistic and the associated P-values. The decision on whether to reject or accept the null hypothesis was based on P-values at 0.05 significance level. The statistical analysis, interpretations and discussions are presented in this section.

4.6.2.1 Effect of Access to Credit on Financial Performance

The study used simple linear regression to test the influence of access to credit on financial performance of SMEs in Kenya. The null hypothesis stated:

$H_0$1: Access to credit has no statistically significant influence on financial performance of SMEs in Kenya.

The results were as shown in the tables; 4.9, 4.10 and 4.11.

Table 4.9: Model Summary for Access to Credit and Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.436[a]	.190	.186	.36280

a. Predictors: (Constant), Access to Credit

Table 4.10: ANOVA for Access to Credit and Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.379	1	5.379	14.797	.000b
	Residual	22.902	63	0.364		
	Total	28.281	64			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Access to Credit

Table 4.11: Regression Coefficients for Access to Credit and Financial Performance

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.260	.246		9.206	.000
	Access to Credit	.402	.063	.436	6.393	.000

a. Dependent Variable: Financial Performance

As indicated in the model summary in Table 4.9, the adjusted R^2 for the model was 0.186, which suggested that access to credit predicted 18.6% of all variations in the financial performance in SMEs in Kenya while 81.4% of all variations in the financial performance of SMEs in Kenya were instigated by other factors other than access to credit.

As shown by the results of the ANOVA in Table 4.10, the F-statistic for the model was 14.797>4.001 F-critical and the p-value =0.000<0.05. The study thus established that the model is a good fit for the data and hence was used to predict the effect of access to credit on the financial performance of SMEs in Kenya.

The regression coefficients results shown in table 4.11 showed un-standardized beta coefficients of; β=2.260; P-value=0.000<0.05 constant and β= 0.402; P-value=0.000<0.05 access to credit, Therefore the simple regression model for starting capital was summarized as follows;

$Y = 2.260 + 0.402X_1$

From the model, holding access to credit constant at zero, financial performance of SMEs in Kenya would be equal to 2.260 while holding all other factors constant, a unit increase in access to credit would lead to a 0.402 increase in the financial performance of SMEs in Kenya.

Since P-value=0.000<0.05 for access to credit indicate a statistical significant influence of access to credit on the financial performance of SMEs in Kenya, the null hypothesis ($H0_1$) which states that, access to credit has no statistically significant effect on financial performance of SMEs in Kenya was rejected and the alternative hypothesis which states that, access to credit has a statistically significant effect on financial performance of SMEs in Kenya was accepted. These findings agree with Otto *et al.* (2010) findings that access to credit has a significant effect on financial performance of SMEs. These findings agree with Mwangi (2014) findings that access to credit influences the financial growth of SMEs. In addition, Nyangoma (2012) found that there is a positive relationship between access to credit and financial performance of SMEs in Kampala.

4.6.2.2 Influence of Starting Capital on Financial Performance

The study used simple linear regression to test the influence of starting capital on financial performance of SMEs in Kenya. The null hypothesis stated:

$H_0$2: Starting capital has no statistically significant effect on financial performance of SMEs in Kenya.

The results were as shown in the tables; 4.12, 4.13 and 4.14.

Table 4.12: Model Summary for Starting Capital and Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.359	0.129	0.112	0.38475

a. Predictors: (Constant), Starting Capital

Table 4.13: ANOVA for Starting Capital and Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	12.523	1	12.523	33.208	.000[b]
	Residual	23.758	63	0.377		
	Total	36.281	64			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Starting Capital

Table 4.14: Regression Coefficients for Starting Capital and Financial Performance

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.075	.183		16.824	.000
	Starting Capital	.195	.047	.299	4.129	.021

a. Dependent Variable: Starting Capital

As indicated in the model summary in Table 4.12, the adjusted R^2 for the model was 0.112, which suggested that starting capital predicted 11.2% of all variations in the financial performance in SMEs in Kenya while 88.8% of all variations in the financial performance of SMEs in Kenya were instigated by other factors other than starting capital.

As shown by the results of the ANOVA in Table 4.13, the F-statistic for the model was 33.208>4.001 F-critical and the p-value =0.000<0.05. The study thus established that the model is a good fit for the data and hence was used to predict the influence of starting capital on the financial performance of SMEs in Kenya.

The regression coefficients results shown in table 4.14 showed un-standardized beta coefficients of; β=3.075; P-value=0.000<0.05 constant and β= 0.195; P-value=0.021<0.05 starting capital, Therefore the simple regression model for starting capital was summarized as follows;

$$Y = 3.075 + 0.195X_1$$

From the model, holding starting capital constant at zero, financial performance of SMEs in Kenya would be equal to 3.075 while holding all other factors constant, a unit increase in starting capital would lead to a 0.195 increase in the financial performance of SMEs in Kenya. Since P-value=0.021<0.05 for starting capital indicate a statistical significant influence of starting capital on the financial performance of SMEs in Kenya, the null hypothesis ($H0_2$) which states that, starting capital has no statistically significant effect on financial performance of SMEs in Kenya was rejected and the alternative hypothesis which states that, starting capital has a statistically significant effect on financial performance of SMEs in Kenya was accepted. The findings are in agreement with Memba (2015) findings that venture capital has a positive

and significant effect on the financial performance of SMEs. These findings concur with Ruri and Omagwa (2018) findings that capital has a significant effect on financial performance of the SMEs.

4.6.2.3 Influence of Interest on Loans on Financial Performance

The study used simple linear regression to test the influence of interest on loans on financial performance of SMEs in Kenya. The null hypothesis stated:

$H_0$3: Interests on loans has no statistically significant influence on financial performance of SMEs in Kenya.

The results were as shown in the tables; 4.15, 4.16 and 4.17.

Table 4.15: Model Summary for Interest and Loans on Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.391[a]	.153	.148	.37104

a. Predictors: (Constant), Interest on Loans

Table 4.16: ANOVA for Interest and Loans on Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.326	1	4.326	11.377	.000b
	Residual	23.955	63	0.381		
	Total	28.281	64			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Interest on Loans

Table 4.17: Regression Coefficients for Interest and Loans on Financial Performance

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.890	.168		17.180	.000
	Interest on Loans	-.245	.044	-.391	-5.606	.003

a. Dependent Variable: Financial Performance

As indicated in the model summary in Table 4.15, the adjusted R^2 for the model was 0.148, which suggested that interest on loans predicted 14.8% of all variations in the financial

performance in SMEs in Kenya while 85.2% of all variations in the financial performance of SMEs in Kenya were instigated by other factors other than interest on loans.

As shown by the results of the ANOVA in Table 4.16, the F-statistic for the model was 11.377>4.001 F-critical and the p-value =0.000<0.05. The study thus established that the model is a good fit for the data and hence was used to predict the influence of interest on loans on the financial performance of SMEs in Kenya.

The regression coefficients results shown in table 4.17 showed un-standardized beta coefficients of; β=2.890; P-value=0.000<0.05 constant and β= -0.245; P-value=0.003<0.05 interest on loans, Therefore the simple regression model for interest on loans was summarized as follows;

$$Y = 2.890 - 0.245X_1$$

From the model, holding interest on loans constant at zero, financial performance of SMEs in Kenya would be equal to 2.890 while holding all other factors constant, a unit increase in interest on loans would lead to a 0.245decrease in the financial performance of SMEs in Kenya. Since P-value=0.003<0.05 for interest on loans indicate a statistical significant influence of interest on loans on the financial performance of SMEs in Kenya, the null hypothesis ($H0_3$) which states that interest on loans has no statistically significant effect on financial performance of SMEs in Kenya was rejected and the alternative hypothesis which states that, interest on loans has a statistically significant effect on financial performance of SMEs in Kenya was accepted. The findings are in agreement with Nyumba *et al.* (2015) argument that interest rates have a negative effect on the performance of small and medium size enterprises in Lurambi Sub-County.

4.6.2.4 Influence of Loan Re-Paying Plans on Financial Performance

The study used simple linear regression to test the influence of loan re-paying plans on financial performance of SMEs in Kenya. The null hypothesis stated:

$H_0$4: Loans re-paying plans have no statistically significant influence on financial performance of SME's in Kenya.

The results were as shown in the tables; 4.18, 4.19 and 4.20.

Table 4.18: Model Summary for Loan Re-Paying Plans and Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.362[a]	.131	.126	.37588

a. Predictors: (Constant), Loan Re-Paying Plans

Table 4.19: ANOVA for Loan Re-Paying Plans on Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.697	1	3.697	9.474	.000[b]
	Residual	24.584	63	0.390		
	Total	28.281	64			

a. Dependent Variable: Financial Performance

b. Predictor: (Constant), Loan Re-Paying Plans

Table 4.20: Regression Coefficients for Loan Re-Paying Plans on Financial Performance

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.508	.258		9.723	.000
	Loan Re-Paying Plans	.347	.068	.362	5.115	.014

a. Dependent Variable: Financial Performance

As indicated in the model summary in Table 4.18, the adjusted R^2 for the model was 0.148, which suggested that loan re-paying plans predicted 12.6% of all variations in the financial performance in SMEs in Kenya while 87.4% of all variations in the financial performance of SMEs in Kenya were instigated by other factors other than loan re-paying plans.

As shown by the results of the ANOVA in Table 4.19, the F-statistic for the model was 9.474>4.001 F-critical and the p-value =0.000<0.05. The study thus established that the model is a good fit for the data and hence was used to predict the effect of loan re-paying plans on the financial performance of SMEs in Kenya.

The regression coefficients results shown in Table 4.20 showed un-standardized beta coefficients of; β=2.508; P-value=0.000<0.05 constant and β= 0.347; P-value=0.003<0.05 loan re-paying plans, Therefore the simple regression model for loan re-paying plans was summarized as follows;

$Y = 2.890 - 0.245X_1$

From the model, holding loan re-paying plans constant at zero, financial performance of SMEs in Kenya would be equal to 2.580 while holding all other factors constant, a unit increase in loan re-paying plans would lead to a 0.347 increase in the financial performance of SMEs in Kenya.

Since P-value=0.014<0.05 for loan re-paying plans indicate a statistical significant effect of loan re-paying plans on the financial performance of SMEs in Kenya, the null hypothesis ($H0_4$) which states that loan re-paying plans has no statistically significant effect on financial performance of SMEs in Kenya was rejected and the alternative hypothesis which states that, loan re-paying plans has a statistically significant effect on financial performance of SMEs in Kenya was accepted. These findings are in line with Akinyi (2012) findings that flexible paying plans positively affected the SMEs' financial performance since it enables them to repay their loans flexibly and does not lead to the repossession of assets. These findings concur with Makundi (2015) loan repayment plans had a significant effect on financial performance of SMEs.

4.6.2.5 Combined Influence of Access to Credit, Capital, Loan Interest and Re-Payment Plans on Financial Performance

The study used multiple linear regression to test the influence of access to credit, capital, loan interest and re-payment plans collectively on the financial performance of SMEs in Kenya.

$H_0$5: Access to credit, capital, loan interest and re-payment plans collectively have no statistically significant influence on the financial performance of SMEs in Kenya.

The regression model was specified as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

The multiple regression analysis results are as shown in tables 4.21, 4.22 and 4.22.

Table 4.21: Model Summary for Combined Influence of Access to Credit, Capital, Loan Interest and Re-Payment Plans on Financial Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.896[a]	0.803	0.792	0.10341

a. Predictors: (Constant), Loan Repayment Plans, Starting capital, Interest on Loans, Access to Credit

Table 4.22: ANOVA for Combined Influence of Access to Credit, Capital, Loan Interest and Re-Payment Plans on Financial Performance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	47.430	4	11.857	1108.894	.000[b]
	Residual	.642	60	.011		
	Total	48.071	64			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Loan Repayment Plans, Starting capital, Interest on Loans, Access to Credit

Table 4.23: Regression Coefficients for Combined Influence of Access to Credit, Capital, Loan Interest and Re-Payment Plans on Financial Performance

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.662	0.133		4.977	0.000
	Access to Credit	0.816	0.161	0.806	5.068	0.000
	Starting capital	0.428	0.188	0.423	2.277	0.034
	Interest on Loans	-0.643	0.138	-0.642	-4.659	0.012
	Loan Repayment Plans	0.517	0.200	0.549	2.585	0.023

a. Dependent Variable: Financial Performance

The model summary table 4.21 results show that there is a strong relationship between selected financial factors and the financial performance of SMEs in Kenya(R=0.896).The adjusted R

square for the model was 0.803 implying that 80.3% of the variations in the financial performance of SMEs in Kenya were explained by changes in access to credit, start-up capital, interest on loans and loan repayments plan. The remaining 19.7% of the variations in the financial performance of SMEs in Kenya are explained by other factors.

The ANOVA results in Table 4.22 show the F-calculated value 1108.894>2.53; P=0.000<0.05. These results show that the model was fit to predict the combined effect of selected financial factors on the financial performance of SMEs in Kenya. Further, based on the ANOVA results, the P-value =0.000<0.05 indicating a statistical significant relationship between selected financial factors and the financial performance of SMEs in Kenya hence the null hypothesis ($H0_1$) which states that combined, selected financial factors on the financial performance of SMEs in Kenya was rejected and the alternative hypothesis which state that combined, access to credit, capital, loan interest and re-payment plans have significant effect on the financial performance of SMEs in Kenya was accepted. The findings agree with Popa and Ciobanu (2015) argument that financial factors have an influence on the profitability of SMEs in Romania. Similarly, the findings agree with Popa and Ciobanu (2015) findings that financial factors have a statistically significant effect on the profitability of SMEs.

The regression coefficient results in table 4.23 indicated that the constant, β=0.662, P=0.000>0.05, coefficient for access to credit, β=0.816; P=0.000<0.05, coefficient for starting capital, β=0.428; P=0.034<0.05, coefficient for interest on loans β=-0.643; P=0.012>0.05, coefficient for loan repayment plans β=0.517; P=0.023>0.05.

Therefore the multiple regression equation was summarized as follows;

$$Y = 0.662 + 0.816X_1 + 0.428X_2 - 0.643X_3 + 0.517X_4$$

This implies that if all variables were held constant at zero, the financial performance of SMEs in Kenya would be 0.662. If all factors were held constant and access to credit increased by one-unit, financial performance of SMEs in Kenya would increase by 0.816. Similarly, all factors were held constant and starting capital increased by one unit, the financial performance of SMEs in Kenya would increase by 0.428. Further, if all factors were held constant and interest on loans increased by one unit, the financial performance of SMEs in Kenya would decrease by 0.643. Loan repayment plans had a positive coefficient implying that if all factors

were held constant and loan repayment plans increased a unit, the financial performance of SMEs in Kenya would increase by 0.517.

CHAPTER FIVE
SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of Findings

The general objective of this study was to determine the influence of selected financial factors affecting the financial performance of SMEs in Kenya. The study came up with a number of key findings on selected financial factors and financial Performance of SMEs in Kenya. The findings are summarized as per the research objectives.

5.2.1 The influence of access to credit on the financial performance of SMEs in Kenya

The first objective of the study was to determine the effect of access to credit on the financial performance of SMEs in Kenya. The null hypothesis tested was access to credit has no statistically significant effect on financial performance of SMEs in Kenya. Based on the results, access to credit has a positive and significant effect on the financial performance of SMEs in Kenya.

In addition, the study established that financial institutions take a lot of time to approve loans applied by SMEs, less time when firms have audited financial documents. In addition, financial institutions demand a lot of collaterals to approve loans applied by SMEs. The study also found that credit for business expansion is easily approved by financial institutions. However, not all SME are granted credit for business expansion. The study revealed that most of the SMEs face challenges related to access credit facilities due to restrictions and requirements. In addition, the study revealed that the time taken between loan application and loan approval was long, through this depends on financial institutions.

5.2.2 The Influence of starting capital on the financial performance of SMEs in Kenya

The second objective of the study was to determine the influence of starting capital on the financial performance of SMEs in Kenya. The null hypothesis tested was starting capital has no statistically significant effect on financial performance of SMEs in Kenya. According to the results, starting capital has a positive and significant influence on the financial performance of the SMEs in Kenya.

The study established that while most entrepreneurs depend on loan facilities to start their businesses, they find it hard to obtain funds for new business. This is because financial institutions need collaterals to approve loans for business start-ups. It was also established that

securing funds for new business is hard as compared to securing funds for boosting business. The study found that financial institutions are the best options for getting loans for starting business. However, it was also established that not all SMEs get loans for their business from banking institutions. The study revealed that since bank loans are very demanding SMEs try to access loans from SACCOs and informal sources of finances like shylocks.

5.2.3 The Influence of interest on loans on the financial performance of SME's in Kenya

The third objective of the study was to establish the effect of interest on loans on the financial performance of SMEs in Kenya. The null hypothesis tested was that interest on loans has no statistically significant effect on financial performance of SMEs in Kenya. From the results, interest on loans has an inverse and statistically significant effect on the financial performance of the SMEs in Kenya.

The study found that apart from the charged interest there are other loan processing charges that make the cost of credit facilities very high. The study revealed that interest on loan charged and the cost of accessing credit facilities by the financial institutions are very high. In addition, the study found that most of the finance managers were not satisfied with the cost of credit and amount of interest charged on loans by the financial institutions. However, most SMEs have no option but to go for the costly loans offered by the financial institutions. Also, some SMEs find it hard to service the applied loans due to high interest rates. Further, the study revealed that SMEs are termed as risk borrowers that are why financial institutions charged very high cost.

5.2.4 The influence of loan re-paying plans on the financial performance of SME's in Kenya

The fourth objective of the study was to determine the effect of loan re-paying plans on the financial performance of SMEs in Kenya. The null hypothesis tested was that loan re-paying plans has no statistically significant effect on financial performance of SMEs in Kenya. According to the results, loan repayment plans have a positive and significant effect on the financial performance of the SMEs in Kenya.

The study established that the loan review process in financial institutions takes a lot of time. The study also established that financial institutions give enough time for loan repayment. In addition, the study revealed that most of the SMEs always repay its loans in time and some of

them find it easy to repay the applied loans due to favorable repayment terms. Also, the study found that loan repayment plans are very lengthy hence loans are not regularly reviewed. In addition, the study found that the process of reviewing the loan repayment plans is very complicated. In addition, some of the finance managers were not aware of any review of loan repayment plans.

5.2.5 The influence of access to credit, capital, loan interest and re-payment plans collectively on the financial performance of SME's in Kenya

The fifth objective of the study was to examine the combined influence of access to credit, capital, loan interest and re-payment plans on financial performance o SMEs in Kenya. The null hypothesis tested was that access to credit, capital, loan interest and re-payment plans collectively have no statistically significant effect on the financial performance of SMEs in Kenya. According to the results, combined, access to credit, capital, loan interest and re-payment plans have significant effect have a statistically significant effect on the financial performance of SMEs in Kenya.

5.2 Conclusion

The study concludes that access to credit has a positive and significant influence on the financial performance of SMEs in Kenya. Access to credit among small and medium enterprises involves ease of getting credit, time taken to get loans, requirements for loans and credit for business expansion. The study also concludes that starting capital has a positive and significant influence on the financial performance of the SMEs in Kenya. Starting capital among small and medium enterprises encompasses ease of obtaining funds for new businesses and need for loans for starting business.

The study concludes that interest on loans has an inverse and statistically significant influence on the financial performance of the SMEs in Kenya. Interest on loans encompasses favorability of loan interests and cost of credit. The study further concludes that loan repayment plans have a positive and significant influence on the financial performance of the SMEs in Kenya. Loan repayment plans involve terms of loan repayments and ease to review loans payments plans.
The study also concludes that the combined financial factors have a significant influence on the financial performance of the SMEs in Kenya. In addition, access to credit affects financial performance of SMEs in Kenya most followed by interest on loans, loan repayment plans and starting capital.

5.3 Recommendations for Policy and Practice

The study concludes that access to credit has a significant influence on the performance of SMEs in Kenya. The study therefore recommends that the financial institutions as well as the government of Kenya should work towards increase access of credit to SMEs in Kenya. Financial institutions can do this by reducing requirements for accessing credit and reducing the duration of time it takes to process loans for SMEs. In addition, the government of Kenya should allocate more funds to the Youth Enterprise Development Fund and Women Enterprise Fund from the current 18.7% of the national budget as a way of ensuring access of credit among the youth and women.

Secondly, the study concluded that starting capital has a significant influence on the performance of SMEs in Kenya. The study therefore recommends that entrepreneurs in Kenya should develop a saving culture where they can save money in commercial banks, microfinance institutions and Sacco's so that when they want to start a business they can access starting capital from these financial institutions.

Thirdly, the study concludes that interest on loans have a negative effect on the financial performance of SMEs in Kenya. Based on this conclusion, the study recommends that financial institutions should reduce interest on loans and the cost involved in processing of loans, which can be done through automation and use of online applications. In addition, the central bank of Kenya, the study recommends the regulation of interest rates charged on loans.

Fourth, the study concludes that loan repayment plans have a significant influence on the financial performance of SMEs in Kenya. From this conclusion, the study recommends that financial institutions should develop a flexible loan repayment plans for SME that puts into consideration economic conditions in the country. In addition, financial institutions should always review the loan repayment plans for SMEs when need be, so as to prevent loan defaults by SMEs.

Besides, the study concluded that combined access to credit, start-up capital, interest on loans and loan repayments plans have a significant influence on the financial performance of SMEs in Kenya. Based on these findings, it is recommended that the management of microfinance institutions in Kenya should seek to adopt numerous strategies together as opposed to a single strategy at a time so as to reduce the level of non-performing loans.

The study also concludes that the combined financial factors such as access to credit, interest on loans, loan repayment plans and starting capital have a significant influence on the financial performance of the SMEs in Kenya. The study therefore recommends that SMEs in Kenya should have proper records and develop a saving culture so as to access credit and starting capital from financial institutions.

5.4 Contributions of the Study to the Body Knowledge

The study contributes to the body of knowledge by proposing a financing model for SMEs based on financial factors to improve financial performance. This is anchored on the adopted conceptual framework which indicated that when combined, access to credit, interest on loans, loan repayment plans and starting capital significantly influence the financial performance of the SMEs in Kenya.

Secondly, the study contributes theoretically to the body of knowledge by validating the applicability of the theoretical anchorage of pecking order theory, the agency theory and the adverse selection theory which had been applied in medium and large enterprises. Thus, by successfully anchoring the conceptualization of access to credit, interest on loans, loan repayment plans and starting capital in this study fill the gap.

Empirically, the study contributes to the body of knowledge by showing the relationship that exists between the study variables among SMEs in Kenya. Existing literature showed that although the study constructs had been studied previously, the scholarship considered their individual influence on financial performance of SMEs and not their combined effect.

5.5 Suggestions for Further Studies

The study focused on the top 100 SMEs in Kenya and most of them had a net income ranging from Ksh. 100 million and Ksh. 25 million. Due to their high income, the accessibility of credit among these SMEs may be different from SMEs with as low as Ksh. 5 million income. The study therefore suggests further studies on other firms SMEs not in the top 100 SMEs. The study found that the selected financial factors could explain 80.3% of the financial performance of SMEs in Kenya. The study therefore recommends further studies on other factors influencing the financial performance of SMEs in Kenya. Also, financial performance was measured in terms of return on assets. Therefore, further studies should be conducted on factors

influencing the financial performance of SMEs to measure performance in terms of return on investment, return on equity, profit margin among other measures.

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APPENDICES

Appendix I : Questionnaire Cover Letter

Egerton University

Department of Accounting, finance and management science

Faculty of Commerce

P.O Box 536-20115

EGERTON

Dear Respondent,

I am a student at Egerton University undertaking Master's Degree. As part of my academic requirement, I am conducting a management research project on the "selected financial factors influencing the financial performance of SMEs in Kenya". Kindly provide the required response as directed in the questionnaires; any response given shall be treated as confidential and no one shall be victimized or intimidated based on any kind of response provided. The response obtained shall be used purposely for research services and the results of the study shall then be availed to any interested party upon request.

Should you have any enquiries or comments regarding this proposal, you are welcome to contact me directly on 0729-613-779. Email: jacksonkirikiru@yahoo.com

Thanking you for your support and cooperation.

Jackson M. Kirikiru

Principle Researcher

Appendix II: Questionnaire

Introduction

This questionnaire is designed for the sole purpose of gathering information on the financial factors that influence the financial performance of SMEs in Kenya. Please give your answers to each of the following questions. Read all the answers first and choose the appropriate answer box by ticking (√) clearly or circling against one item for each question.

Firms Name ……

Department / Section …….

SECTION A: Demographic Information

1. Gender

   Male ()

   Female ()

2. Kindly indicate how long you have been working in your organization?

   Lessthan2years ( )

   Between3-5years ( )

   Between 6-10years ( )

   More than10years ( )

3. Please indicate the highest level of education completed

   Diploma ( )

   Undergraduate Degree ( )

   Master degree ( )

   PHD ( )

SECTION B: ACCESS TO CREDIT

4. Kindly indicate your level of agreement on various statements on access to credit and SME performance in your organization. Where 1 symbolizes strongly disagree, 2 symbolizes disagree, 3 symbolizes neutral, 4 symbolizes agree and 5 symbolizes strongly agree.

Statement	**1**	**2**	**3**	**4**	**5**
Ease of getting credit					

SME find it easy to access to credit facilities from financial institutions					
We always access credit facilities without much restrictions					
Most SMEs lack audited financial statements hence find it hard to access credit facilities					
Time taken to get loans					
The time taken between loan application and loan approval is very short					
Financial institutions take a lot of time to approve loans applied by SME					
loan application takes less time when firms have audited financial documents					
Requirements for Loans					
Audited financial statements are required for loan application by the SME					
Financial institutions demand a lot of collaterals to approve loans applied by SME					
Our organization has all the essential requirements for loan approval by the financial institutions					
Credit for business expansion					
Credit for business expansion is easily approved by financial institutions					
Not all SME are granted credit for business expansion					
We have severally applied for business expansion loans and all applications have been approved					

SECTION C: STARTING CAPITAL

5. Kindly indicate your level of agreement on various statements on starting capital and SME performance in your organization. Where 1 symbolizes strongly disagree, 2 symbolizes disagree, 3 symbolizes neutral, 4 symbolizes agree and 5 symbolizes strongly agree.

Statement	**1**	**2**	**3**	**4**	**5**
Ease of obtaining funds for new businesses					
Securing funds for new business is hard as compared to securing funds for boosting business					
Financial resources need collaterals to approve loans for business start-ups					
entrepreneurs find it hard to offer obtain funds for new business					
There are many source of funds for new businesses					
Need for Loans for Starting Business					
Most SMEs depend on loan facilities to start their business					
Loan facilities for starting new business need collateral for approval					
Financial institutions are the best options for getting loans for starting business					
Not all SME get loans for their business from banking institutions					
Bank loans are very demanding therefore SMEs try to access loans from SACCOs					

SECTION D: INTEREST ON LOANS

6. Kindly indicate your level of agreement on various statements on interest on loans and SME performance in your organization. Where 1 symbolizes strongly disagree, 2 symbolizes disagree, 3 symbolizes neutral, 4 symbolizes agree and 5 symbolizes strongly agree.

Statement	**1**	**2**	**3**	**4**	**5**
Favorability of Loan Interests					
The interest on loan charged by the financial institutions is very high					
Some SMEs find it hard to service the applied loans due to high interest rates					
Our organizations finds the interest charged on loans very favorable					
We are satisfied with the amount of interest charged on loans by the financial institutions					

Cost of credit					
The cost of accessing credit facilities is very high					
Apart from the charged interest there are other loan processing charged that makes the cost of credit facilities very high					
I am not satisfied with the cost of credit facilities charged by the financial institutions					
Most SMEs have no option but to go for the costly loans offered by the financial institutions					
SMEs are termed as risk borrowers that is why financial institutions charged very high cost					
Our institution finds it hard to manage loan repayment due to the high cost on the loans					

SECTION E: LOAN REPAYMENT PLANS

7. Kindly indicate your level of agreement on various statements on loan repayment plans and SME performance in your organization. Where 1 symbolizes strongly disagree, 2 symbolizes disagree, 3 symbolizes neutral, 4 symbolizes agree and 5 symbolizes strongly agree.

Statement	**1**	**2**	**3**	**4**	**5**
Terms of Loan repayments					
The terms on loan repayment are favorable for SMEs					
Most SMEs find it easy to repay the applied loans due to favorable repayment terms					
Financial institution give enough time for loan repayment					
I am satisfied with the loan repayment terms from the financial institutions					
Our organization always repay its loans in time					
Ease to review loans payments plans					
The loan repayment plans are regularly reviewed					
The process of reviewing the loan repayment plans is very complicated					
The loan review process takes a lot of time					
Loan repayment plans are very lengthy hence not regularly reviewed					

SECTION F: Financial Performance

8. Kindly tick (√) the total assets in in your SME in the last one year.

   Below 300 million [ ]

   301 million – 600 million [ ]

   601 million –900 million [ ]

   901 million – 1.2 billion [ ]

   Above 1.2 billion [ ]

9. Kindly tick (√) the most important appropriate profitability for your SME

   Below 100 million [ ]

   101 – 200 million [ ]

   201 – 300 million [ ]

   301 – 400 million [ ]

   Above 400 million [ ]

Thank you for our participation

APPENDIX III: TOP 100 COMPANIES (SMES) IN KENYA

	Companies	Category		Companies	Category
1	VarsaniBrakeline Limited	Automobile	51	Orange Pharma Ltd	Manufacturing
2	Amex Auto & Industrial Hardware Ltd	Automobile	52	Synermedica (Kenya) Limited	Manufacturing
3	General Automobile Corporation	Automobile	53	Syner-Med	Manufacturing
4	MPPS Accessories	Automobile	54	MukurweiniWakuli ma Dairy	Manufacturing
5	Lota Motors Ltd	Automobile	55	Palmhouse Dairies	Manufacturing
6	Bagda's Auto Spares Ltd	Automobile	56	Melvin Marsh International Ltd	Agriculture
7	Oil Seals & Bearings Centre Ltd	Automobile	57	Super Broom Services Ltd	Cleaning
8	Master Fabricators Ltd	Automobile	58	Makini School	Education
9	Manix Clothing	Construction	59	BIMAS Kenya Limited	Financial
10	Mandhir Construction Limited	Construction	60	MIC Global Risks Insurance Brokers (K) Ltd	Insurance
11	Waterman Drilling Africa	Construction	61	Classic Mouldings Ltd	Interior design
12	Specialized Aluminum Renovators Limited (SARL	Construction	62	Superior Homes Kenya	Real estate
13	Hydro Water Well (K) Ltd	Construction	63	Riley Services Ltd	Security
14	Komal Construction	Construction	64	Computer Pride	Training services
15	Kisima Drilling	Construction	65	Polucon Services	Supply and Logistics
16	Hajar Services Ltd	Construction	66	Emmerdale Limited	Supply and Logistics
17	Philafe Engineering Ltd	Construction	67	Vinep Forwarders Limited	Supply and Logistics
18	Trident Plumbers Ltd	Construction	68	Express Kenya Limited	Supply and Logistics
19	Care Chemists	Health	69	Uneek Freight Services	Supply and Logistics
20	Valley Hospital	Health	70	Polygon Logistics Ltd	Supply and Logistics
21	Pathcare Kenya Ltd	Health	71	Roy Transmotors Ltd	Supply and Logistics
22	Executive Healthcare Plan	Health	72	Hipora Business Solutions	Supply and Logistics
23	Waterbuck	Hospitality	73	General Cargo Services Ltd	Supply and Logistics
24	Zen Garden	Hospitality	74	North Star Cooling Systems	Supply and Logistics
25	Pinnacle (K) Travel & Safaris Ltd	Hospitality	75	Ravenzo Trading Limited	Supply and Logistics

26	Xtreme adventures limited	Hospitality	76	SolohWorldWide Inter-Enterprises Limited	Supply and Logistics
27	Gina Din Corporate Communications	ICT	77	Prafulchandra& Brothers Ltd	Supply and Logistics
28	Isolutions Associates	ICT	78	Sheffield Steel Systems Limited	Supply and Logistics
29	Novel Technologies (E.A) Ltd	ICT	79	Skypex Supplies Ltd	Supply and Logistics
30	Software Technologies Limited	ICT	80	Nairobi Enterprises Ltd	Supply and Logistics
31	BluekeySeidor	ICT	81	Patmat Bookshop Ltd	Supply and Logistics
32	Impax Business Solutions	ICT	82	Elite Tools	Supply and Logistics
33	Avtech Systems Ltd	ICT	83	Sensations Limited	Supply and Logistics
34	Advanta Africa Ltd	ICT	84	Typotech Imaging Systems Ltd	Supply and Logistics
35	eMomentum Interactive	ICT	85	Synergy Gases (K) Ltd	Supply and Logistics
36	Well Told Story	ICT	86	Machines Technologies Limited	Supply and Logistics
37	Specicom Technologies Ltd	ICT	87	Astral Industries Ltd	Supply and Logistics
38	Total Solutions Ltd	ICT	88	Warren Enterprises	Supply and Logistics
39	Furniturerama	Manufacturing	89	Nationwide Electrical Industries	Supply and Logistics
40	Napro Industries Ltd	Manufacturing	90	Allwin Packaging	Supply and Logistics
41	Vivek Investments Ltd	Manufacturing	91	Sollatek Electronics	Supply and Logistics
42	ZaverchandPunja LTD	Manufacturing	92	SpecialisedHardwares	Supply and Logistics
43	Economic Industries Ltd	Manufacturing	93	Smart Brands Limited	Supply and Logistics
44	Fayaz Bakers Limited	Manufacturing	94	Farm parts Limited	Supply and Logistics
45	Thika Cloth Mills Limited	Manufacturing	95	Educate Yourself Ltd	Supply and Logistics
46	Maroo Polymers	Manufacturing	96	Rift Valley Machinery Services Ltd	Supply and Logistics
47	Orbit Engineering Ltd	Manufacturing	97	United Engineering Supplies Limited	Supply and Logistics
48	Norda Industries	Manufacturing	98	Ndugu Transport Company Limited	Supply and Logistics
49	Ideal Manufacturing	Manufacturing	99	Kenya Bus Services Management Limited	Supply and Logistics
50	Canon Aluminium Fabricators	Manufacturing	100	Rongai Workshop & Transport	Supply and Logistics

Source: Ministry of Industrialization, Trade and Enterprise Development (2018)

Appendix III: NACOSTI Research Authorization

NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY AND INNOVATION

Telephone:+254-20-2213471,
2241349,3310571,2219420
Fax:+254-20-318245,318249
Email: dg@nacosti.go.ke
Website : www.nacosti.go.ke
When replying please quote

NACOSTI, Upper Kabete
Off Waiyaki Way
P.O. Box 30623-00100
NAIROBI-KENYA

Ref: No. **NACOSTI/P/19/45142/31207**

Date: **25th June, 2019**

Jackson Macharia Kirikiru
Egerton University
P.O. Box 536-20115
NJORO.

RE: RESEARCH AUTHORIZATION

Following your application for authority to carry out research on ***"Factors influencing financial performance of Small and Medium Enterprises in Nairobi City County, Kenya"*** I am pleased to inform you that you have been authorized to undertake research in **Nairobi County** for the period ending **24th June, 2020.**

You are advised to report to **the County Commissioner and the County Director of Education, Nairobi County** before embarking on the research project.

Kindly note that, as an applicant who has been licensed under the Science, Technology and Innovation Act, 2013 to conduct research in Kenya, you shall deposit **a copy** of the final research report to the Commission within **one year** of completion. The soft copy of the same should be submitted through the Online Research Information System.

BONIFACE WANYAMA
DIRECTOR GENERAL/CEO

Copy to:

The County Commissioner
Nairobi County.

The County Director of Education
Nairobi County.

National Commission for Science, Technology and Innovation is ISO9001: 2008 Certified