EFFECT OF ISLAMIC BANKING ON GROWTH OF SMALL MEDIUM ENTERPRISES IN NAIROBI: A CASE STUDY OF FIRST COMMUNITY BANK

BY

ABDIAZIZ YUSSUF

UNITED STATES INTERNATIONAL UNIVERSITY
AFRICA

SPRING, 2017
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A Project Submitted To the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Global Executive Masters of Business Administration (GeMBA)

UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

SPRING, 2017
DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: ___________________________ Date: ___________________________

Abdiaiz Yussuf (ID 650048)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: ___________________________ Date: ___________________________

Francis Wambalaba, PhD., AICP

Signed: ___________________________ Date: ___________________________

Gorge Achoki
Dean, Chandaria School of Business
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My special thank you goes to Allah, the Lord of the Universe, for giving me health and the strength to persevere all the obstacles that came on my way.

I also do thank and appreciate my supervisor Francis Wambalaba (PhD., AICP) for guidance that made it possible to carry out this project.

I also like to express my gratitude to first community Bank Employees and Customers, without whom this research would not have been successful.
DEDICATION

This work is dedicated to my family and friends as they have seen me through my studies. They have shown their sincere and relentless contributions towards creating an ideal environment to enable me further my studies.
ABSTRACT

Islamic banking has gained a lot of significance in the contemporary world on the basis of provision of zero interest loans coupled with sharing of profits and losses through the principle of mudharabah (profit-sharing) and musyarakah (joint-venture). Islamic banking differs from conventional banking systems in many ways; the major difference being the use of Interest or usury. Small and medium enterprises (SMEs) are commonly acknowledged as the economy drivers and the Key contributors to gross domestic product (GDP) around the globe, including those countries in Africa and East Africa region especially Kenya. The SMEs growth has also been hindered by Market inflations that keep on altering the commercial banks rates; therefore there is a demand for Islamic Shariah banking and innovations. The Kenyan banking sector has been in a stiff competition to capture the SME market; this has impacted the growth of the SME business in the country.

The purpose of this study was to determine the effect of Islamic banking on SMEs in Nairobi City. The study was guided by the research questions: determine the effect of Islamic banking on SMEs in Nairobi City?; What are the effects of Islamic banking on growth of SMEs in Nairobi City? And what are the effects of Islamic banking on financial literacy of SMEs in Nairobi City?

The study adopted a descriptive research design in establishing effect of Islamic banking on growth of SMEs in Nairobi which is a shariah compliant bank. The target population included 4000 SMEs that operate within Nairobi Central Business District and all the 103 employees working in different branches of the First Community Bank within Nairobi. Using cluster sampling the study used a total of 440 respondents: 360 from the SME owners and 80 First Community Bank employees. The study collected primary data using structured and closed ended questionnaires as the research instrument. The data was collected using drop and pick later method and follow up via telephone calls. The collected data was summarized, coded, tabulated and analyzed. The study derived the mean, frequencies and percentages from the data analysis for each variable. Results of the study were presented in tables, pie charts and bar graphs.
The study findings of the study on the effect of Islamic banking on financial performance of SMEs indicated that the management team was able to improve the financial profitability and that Islamic banking has led to growth of my SME financially. Regarding the effect of Islamic banking on growth of SMEs, the study established that Islamic banking has offered me a different banking product from the formal banking products and that Islamic banking has ensured equitable access to credit for my business growth. On the effect of Islamic banking on credit accessibility among SMEs, the study found out that Islamic banking has customized its products for businesses. In respect to the effect of Islamic banking on financial literacy among SMEs, the findings of the study indicated that Islamic banking has improved financial decision making processes.

The study concludes that Islamic banking helps SMEs to grow financially which enhances their financial performance. The study also concludes that Islamic banking affects the growth of SMEs. The study further concludes that Islamic banking despite the existence of a reasonably well-developed Islamic banking sector; (SMEs) have typically remained underfunded. Moreover, Islamic banking has affected SMEs’ financial literacy by improving on their financial decision making processes.

The study recommends that the management of SMEs should seek to enhance their financial performance by increasing their uptake of the Islamic banking products. The study also recommends that SMEs should enhance their growth by actively substituting the different banking products given by Islamic banking system. The study further recommends that the management team of SMEs should seek highly customized financial products from Islamic banks to enhance credit accessibility. The study also recommends that SMEs should make prudent and rational decisions in connection to Islamic banking products as a way of enhancing their financial literacy.
TABLE OF CONTENT

DECLARATION ........................................... iii
COPYRIGHT ................................................ iv
ACKNOWLEDGEMENT ....................................... v
DEDICATION ................................................ vi
ABSTRACT .................................................. vii
LIST OF TABLES ........................................... xi
LIST OF FIGURES .......................................... xii
ABBREVIATIONS AND ACRONYMS ......................... xiii

CHAPTER ONE .................................................. 1
1.0 INTRODUCTION ........................................ 1
1.1 Background of the Study ................................ 1
1.2 Problem Statement ..................................... 6
1.3 Purpose of the Study ................................... 7
1.4 Research Questions ..................................... 7
1.5 Significance of the Study ............................... 7
1.6 Scope of the Study ..................................... 8
1.7 Definition of Terms ..................................... 9
1.8 Chapter Summary ....................................... 10

CHAPTER TWO ............................................... 11
2.0 LITERATURE REVIEW ................................ 11
2.1 Introduction ............................................ 11
2.2 Islamic Banking and its Effect on Financial Performance of SMEs ........................................... 11
2.3 Islamic Banking and its Effect on Growth of SMEs ....................................................... 15
2.4 Islamic Banking and its Effect on Credit Accessibility among SMEs ........................................... 19
2.5 Islamic Banking and its Effect on Financial Literacy of SMEs ............................................. 23
2.6 Chapter Summary ....................................... 28
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
3.2 Research Design
3.3 Population and Sampling Design
3.4 Data Collection Methods
3.5 Research Procedures
3.6 Data Analysis Methods
3.7 Chapter Summary

CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
4.2 Demographic Information
4.3 Effect of Islamic Banking on Financial Performance of SMEs
4.4 Effects of Islamic Banking on Growth of SMEs
4.5 Islamic Banking and Credit Accessibility among SMEs
4.6 Effects of Islamic Banking on Financial Literacy of SMEs
4.7 Chapter Summary

CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
5.2 Summary of the Study
5.3 Discussion
5.4 Conclusions
5.5 Recommendations

REFERENCES

APPENDICES

Appendix I: Questionnaire
LIST OF TABLES

Table 3.1: Sample Size ........................................................................................................... 31
Table 4.1: Competitive Advantage .......................................................................................... 37
Table 4.2: Profitability ............................................................................................................ 38
Table 4.3: Optimal Resource Use ............................................................................................ 39
Table 4.4: Liquidity ................................................................................................................ 39
Table 4.5: Extent to which Islamic Banking affected Financial Performance ....................... 40
Table 4.6: Starting Capital ....................................................................................................... 41
Table 4.7: Funds for Increasing Inventory .............................................................................. 41
Table 4.8: Effects of Islamic Banking on Growth of SMEs .................................................... 42
Table 4.9: Extent to which Islamic Banking Affects Growth of SMEs .................................... 43
Table 4.10: Low Interest Rate ................................................................................................. 44
Table 4.11: Aligning Islam Banking Processes to fit SMEs Needs ........................................ 45
Table 4.12: Islamic Banking and Credit Accessibility among SMEs ....................................... 45
Table 4.13: Extent to which Islamic Banking Affect Credit Accessibility ............................... 46
Table 4.14: Financial Behaviors and Attitudes ...................................................................... 46
Table 4.15: Financial Decisions .............................................................................................. 47
Table 4.16: Solving Business Problems .................................................................................. 48
Table 4.17: Extent to which Islamic Banking Affected Financial Performance ....................... 48
LIST OF FIGURES

Figure 4.1: Response Rate .......................................................................................... 35
Figure 4.2: Gender of the Respondents...................................................................... 36
Figure 4.3: Highest Level of Education Attained ...................................................... 36
<table>
<thead>
<tr>
<th>ABBREVIATIONS AND ACRONYMS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CBD</strong></td>
</tr>
<tr>
<td><strong>FCB</strong></td>
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<td><strong>GAB</strong></td>
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<td><strong>GDP</strong></td>
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<td><strong>IFC</strong></td>
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<tr>
<td><strong>KCB</strong></td>
</tr>
<tr>
<td><strong>MENA</strong></td>
</tr>
<tr>
<td><strong>SBP</strong></td>
</tr>
<tr>
<td><strong>SME</strong></td>
</tr>
</tbody>
</table>
CHAPTER ONE

1.0 INTRODUCTION
1.1 Background of the Study

The banking system whose activities and operations are governed by the Islamic or Syariah rules is generally defined as Islamic Banking (Haron, Sudin & Wan-Nursofiza-Wan-Azmi, 2009). The other definition of Islamic banking is borrowed from Aburime and Alio (2009) as a system of banking or activity which complies with the Islamic law Shariah principle and guided by the Islamic economics whose key objective is premised on the notions of equitable resource distribution and social justice. The term Islamic banking has gained a lot of significance in the contemporary world on the basis of provision of zero interest loans coupled with sharing of profits and losses through the principle of mudharabah (profit-sharing) and musyarakah (joint-venture) (Buksh, 2010).

According to Fasih (2012) islamic banking is an interest-free banking system founded on real assets and the risks are shared between the lender and borrower under the mechanisms of partnership, joint ownership, lease, and sale. The main features of Islamic banking include interest free loans, low consumer lending and profit and loss sharing. With the interest-free loans, banks are prohibited from paying or earning interest on loaned funds. As such, these banks are only allowed to collect the amount equivalent to the loaned principal amount (Aburime & Alio, 2009). Islamic banking also refers to a way of banking or banking activity that's in the accordance with the principles of the Shariah (Islamic rulings), i.e. adherence to Islamic values and principles of trading. The Shariah (Islamic rulings) does not allow the use of Riba (interest/usury) that, literally means an "increment' or addition" (Khattak & Rehman, 2010).

Islamic banking differs from conventional banking systems in many ways; the major difference being the use of Interest or usury. Unlike conventional banking, Islamic banking is not allowed to engage in any Haram (unlawful or illegal) business activities, this means that any business that has not been permitted by the Islamic sharia principles or prohibited
according to the Islamic books (Quran, Hadith and Fiqh) falls under Haram (illegal or unlawful) these includes interest bearing loans, Alcohol Business, Gambling, Pork Business or any other business activities that has ill motive to the society. Also in conventional banking money has value while In Islamic banking money has no inherent utility meaning has no value, ‘if one is stuck on a desert, he cannot eat, drink or wear that money, justifying the reason for money not having value in itself’(Usmani, 2007). SMEs should look at their strengths and opportunities in order to exploit their strategic abilities to overcome their weaknesses and threats in order to improve their performance, effectively grow in their financial earnings and expand their operations and produce to new markets (Papulova & Papulova, 2006).

Dubai Islamic Bank, world’s first fully-fledged Islamic bank, was established in 1975. Islamic Development Bank was established in the same year as a follow-up of decision of Conference of Finance Ministers of Muslim Countries. Today, Islamic banks and financial institutions are enjoying remarkable growth globally with estimated asset of US$1.1 trillion in 2012, a significant jump of 33% from 2010 level of US$826 billion (Rahman & McDonald, 2015). According to Jaffar and Musa (2014) the global Islamic banking and finance industry assets worth at over USD1.3 trillion in 2012 are expected to reach USD 2 trillion in next three to five years. Islamic banking has become a global brand, sophisticated and organized industry in the past four decades as a result of its unique features of interest free loans, low consumer lending and profit and loss sharing (Halal Focus, 2011). The largest centers of Islamic banking are concentrated in Malaysia and the Middle East, including Iran, Saudi Arabia, UAE and Kuwait (UKIFS, 2013). Although much of the concentration of Islamic banking has been concentrated in Malaysia and Gulf Cooperation Council countries, it has however expanded throughout the Middle East, Indonesia, the United Kingdom, North Africa, and, more recently, in some Sub-Saharan African countries (Gelbard, Hussain, Maino, Mu & Yehoue, 2014).

In United Kingdom UK, Islamic banking was welcomed since its early emergence in the late 1970s and early 1980s. Today, Islamic banking has rapidly grown in UK as it is a major global provider of the specialist legal expertise required for Islamic finance, with
around 25 major law firms providing legal services in this area. London, in particular, has become an important financial Centre, where major international firms and the Middle East’s biggest traditional banks are offering Islamic financial products and services in this city (Filippo, Caristi, Couderc, Maria, Grewal, Masciantonio, Ongena & Zaher, 2013). Currently, UK is the leading Western country and Europe’s premier Centre for Islamic banking. It is well positioned to capture a growing share of Islamic banking business in the coming years (UKIFS, 2013). According to the Banker magazine’s latest Islamic Finance survey, the UK ranks as the ninth largest global location for managing Islamic finance assets, with $19bn in reported assets (The Banker, 2012).

Islamic banking in Pakistan emerged as a response to both religious and economic needs during 1970s and most of the significant and practical steps were taken in 1980s. By mid-80s, Islamic banking had grown and developed in Pakistan than any other part of the world at that time (Daud, Yussof & Abideen, 2011). In Indonesia, Islamic banking has undergone tremendous growth and development in the last decade since it is a country with largest Muslim population worldwide (Jamaludin, 2013). The findings from Indonesia Finance Service Authority (OJK) (2014) indicates that the financing portfolio given by the Islamic banks to small medium enterprises (SME) increased from approximately IDR48 billion in 2006 to IDR110 billion in mid 2014. Islamic banking has a social obligation to provide financing for SMEs although a number of barriers come in to reduce efficiency. These barriers include the problems of asymmetric information, physical barriers of poor infrastructure, socioeconomic factors, lack of collateral and high transaction cost (Ahmed, 2004). In United Arbaş Emirates, the existence of shariah advisory council that overview whether the activities financed by Islamic banks are in line with its principles limits the accessibility of the Islamic banking products to individuals in the country (Shubber, 2011).

In Bangladesh, Islamic banking came into existence with certain objectives, in line with the philosophy of Islamic economics that imply a direct and specific responsibility on their part to play an effective role in the socioeconomic development of the country (Rahman & McDonald, 2015). In Malaysia, there has been low usage of Islamic banking products since Non Muslims have low knowledge on Islamic banking principles and Islamic financial
system especially in understanding on the nature of profit-sharing concept (Ahmad & Haron, 2002). In Libya, Gait and Worthington (2009) established that the majority of the Libyan business firms are interested to use Islamic finance, despite informal practice of Islamic financial institution in the country. The motivating factors for business firms to potentially use Islamic finance are religion, followed by profitability, business support and unique services (Gait & Worthington, 2009).

In Mauritius, Islamic banking has been in present since 1998 when the small Muslim community of the island started receiving services from the Al Barakah Cooperative Society Limited, an Islamic cooperative credit union, which offers tailor-made Murabaha schemes, Hajj saving accounts, and Istisna’ financing (Islamic Globe, 2012). In Nigeria, Islamic banking is very low despite the country hosting the largest Muslim population in Sub-Saharan Africa, (about half of its 170 million people). Habib Bank (now Bank PHB) was the first bank operating an Islamic banking window (in 1992) (Arab News, 2009). For South Africa, despite its small Muslim population (1.5 percent), the country was the first Sub-Saharan African country to establish itself as a potential hub for Shari’ah-compliant banking in the region. In 1989, Al Baraka—which part of the Saudi Arabian-based Dallah Al Baraka group—and the Islamic Bank were the first Islamic banks granted licenses by the South African Reserve Bank (Bloomberg News, 2014).

In Kenya the first Islamic bank Gulf African bank commenced its operations in the year 2005 (Maryke, 2003). Latter on First Community Bank in 2007 and Gulf African Bank (GAB) in 2008 started their Islamic banking businesses in Kenya. Other conventional banks such as Kenya Commercial Bank now offer Shari’ah compliant products through special Islamic windows (McCormick, 2012). In 2010, through the Finance Act, the Kenyan authorities amended Section 45 of the Central Bank of Kenya Act to allow the Central Bank as the government’s fiscal agent to recognize the payment of a return rather than interest on government securities, thereby opening up the spectrum of Shari’ah compliant investments in the country. By the end of 2013, Islamic banking accounts for two percent of the total banking business in Kenya (Ndung’u, 2011). By the Year 2013 Islamic banking has been operating in over 300 intuitions in 75 countries (Cihak & Hesse,
Subsequently Islamic windows were initiated by various conventional banks to cap the competition and to meet the Islamic Shariah services demand in the market i.e. La Riba – Barclays. These have also affected positively the growth of both corporate and SMEs business in Kenya.

Small and medium enterprises (SMEs) are commonly acknowledged as the economy drivers and the Key contributors to gross domestic product (GDP) around the globe, including those countries in Africa and East Africa region especially Kenya. These businesses create employment opportunities for both skilled and unskilled person. However, market conditions such as Banks’ strict procedures in Obtaining financings or credit facility and regulatory environments are not always supportive of the growth of SMEs these are one of the main obstacles they face.

Approximately 60-70% of the businesses in Nairobi are SMEs. The growths of SMEs business are thereby mainly dependent on lending or financing offered by commercial banks that exist in the city. Although these have had an impact on the SME growths, more and more business has been dwindling downwards due to exorbitant interest rates that have locked out many business. Some businesses also collapsed due to unfavorable market conditions. Other condition such as complex credit procedures, provisions of collaterals for facilities to be borrowed has been the hindrances for SMEs to accesses financing.

The SMEs growth has also been hindered by Market inflations that keep on altering the commercial banks rates; therefore there is a demand for Islamic Shariah banking and innovations such include ‘Murabaha’ ‘Mudarabah’, ‘Musharakah’ and ‘service Ijara’ which are unique to Islamic banking and that affect positively the SMEs environment. Islamic banks simplified the mode of banking by doing business free of interest thus leading to high competition among the banking industry and the scrabble for SME customers that contribute to the largest customer segment in the banking industry.

The Kenyan banking sector has been in a stiff competition to capture the SME market; this has impacted the growth of the SME business in the country. Islamic banks in Kenya has also played major role in the growth of SMEs with the two fully fledged Islamic banks
First Community Bank (FCB) and Gulf African bank (GAB) playing an important role in shaping the growth of SME Businesses in Kenya and with concentration to Nairobi Market.

1.2 Problem Statement

Islamic banking is relatively new, its contribution to the country’s economy is relatively as well not clear. In addition, researchers have not yet fully covered the impact of Islamic banking to the growth of SMEs in Kenya. There is a need to comprehend how the two fully fledged Islamic Shariah banks are affecting the growth of SME business in Nairobi-Kenya (with focus on first community bank). With current stiff competition from conventional banks offering same Islamic sharia products through Islamic windows, it’s important to understand how SMEs businesses in Nairobi have fully utilized the Islamic banking products to impact on SME business.

Hove, Sibanda and Pooe (2014) established that Islamic banking had a positive and significant impact on both entrepreneurial motivation and firm competitiveness in South Africa. The study indicated that through Islamic banking, SMEs were able to access credit at lower interest rates through customer relationship management and profiling. In another study, Tuitoek (2012) established that offering sharia compliant products have improved the financial performance of commercial banks in Kenya. Salim (2014) identified various modes of financing used by Islamic banking including diminishing Musharaka, Ijara and Murababa.

Islam, Yousuf and Rahman (2014) conducted a comparative analysis of conventional and Islamic banks by looking at SME financing in Bangladesh. The findings indicated that disbursement of SME Loan by all selected conventional banks showed about 1.5 times growth from Year 2009-2011 as compared to disbursement of SME Loan by all Islamic banks that portrayed about 1.35 times growth. These studies explored other aspects of Islamic banking from different contexts which therefore limit their application in the current study. This therefore leaves a research gap that this study sought to fill by analyzing the effect of Islamic banking on SMEs in Nairobi City.
1.3 Purpose of the Study.
The purpose of the study was to determine the effect of Islamic banking on SMEs in Nairobi City.

1.4 Research Questions
From the purpose of the study, it sought to answer the following research questions:
1.4.1 How has Islamic banking affected financial performance of SMEs in Nairobi City?
1.4.2 What are the effects of Islamic banking on growth of SMEs in Nairobi City?
1.4.3 How has Islamic banking affected credit accessibility among SMEs in Nairobi City?
1.4.4 What are the effects of Islamic banking on financial literacy of SMEs in Nairobi City?

1.5 Significance of the Study
With the recognition of the effect of Islamic banking to growth of SME the study was of great importance to various stakeholders as addressed hereunder:

1.5.1 Academicians and Researchers
The study would make a significant contribution to the existing body of knowledge in the field of Islamic Banking and SMEs Business in Nairobi. The study would act as a source of empirical literature that future researchers can cite in their studies besides suggesting areas for further research.

1.5.2 The Board, Management and Employees of First Community Bank
The study would be of important to the board members of First Community Bank as it would prove the effect the bank has had on its SME customers thereby inform better decision making. It is hoped that through the findings of this study, the management team at the Bank would be informed on the various effects that Islamic banking has affected SME market in Nairobi County hence its contributions to Kenya’s economic development. For the management the study would be of importance especially for the role they have to play or adopt in marketing and Needs of SME business and areas to be improved. For the employees it would be of importance to identify the marketing needs, customer relationship
improvement so as to establish ways of improving service experience for optimal customer satisfaction. It is further hoped that through the findings of this study, the Bank would be in a position to identify products and services that are not performing well so as to inform decision making on how to improve the competitiveness of the Bank.

1.5.3 Policy Makers

The study would also be useful to the Government of Kenya in policy making regarding policies and regulations on SME market and other regulatory requirements of the financial sectors. It is hoped that through the findings of this study, the Government of Kenya especially the Ministry of Public Service, Youth & Gender Affairs in development of policies governing different special groups and business development in the Country.

1.5.4 SMEs Businesses

The study would be of importance to the SME businesses or community for it would assist them understand their value to the country’s economic growth, and explore the information on Islamic banking for better decision making in terms of borrowing loans or transacting with banks.

1.6 Scope of the Study

The study sought to establish the effect of Islamic Banking on SMEs business in Nairobi (Kenya). The target population for this study was 440 respondents including 360 SMEs located within Nairobi CBD and who were customers of the First community bank and 80 employees of First Community Bank. The variables of study were growth, credit accessibility, financial performance and financial literacy. The study targeted all SMEs within Nairobi Central Business District. The study was undertaken in the Month of September, 2016.

The study expected that some respondents were unwilling to share some sensitive information and they might be busy all the time with their job tasks. To counter this researcher carried an introduction letter from USIU assuring that the information requested
was for academic purposes only. In response to the respondents being busy; the researcher shall applied a drop and pick later method in data collection.

1.7 Definition of Terms

1.7.1 Islamic Banking
Islamic banking is the selling of insurance and banking products through the same channel, most commonly through bank kindling selling insurance (Kumar & Gulati, 2009).

1.7.2 Riba
It’s an Arabic word, meaning increase or add, using money as a commodity. Translated as interest by English

1.7.3 Sharia
The Islamic law that is usually governed by the teachings of Islamic books (Quran, Hadith and Fiq) (Khattak & Rehman, 2010).

1.7.4 Musharakah
Means joint venture contract, or a relationship between two business partners where they contribute capital for business purpose. The business proceeds is shared as per the contributions ratio.

1.7.5 Mudarabah
Business contract - one partner (Rab-ul-mal/financier) invests in a commercial enterprise managed by another partner (mudarib) (Iqbal, 2002).

1.7.6 Murabah
A sale in which the seller’s cost and profit are disclosed to the buyer (Kenya Bankers Association, 2013).

1.7.7 Ijara
‘Arabic word for a wage or a leasing contract. Under Ijara contracts, the owner of an asset allows the use of sharia-compliant assets by the user for sharia-permissible purposes’ (Salman, 2010).
1.8 Chapter Summary
This chapter looked at the background of the study in laying the underground work for this study in trying to understand the effect of Islamic banking on SMEs in Nairobi City. It has sections on problem statement to get the knowledge gap and how this study intends to fill it. It has sections on the objectives of the study and the research questions. The study shows the significance of the study, the scope and definition of key terms that were used in the study. This chapter laid the foundation for understanding the effect of Islamic banking on SMEs in Nairobi City.

Chapter two reviewed the literature related to the study from other scholars. It presents the theoretical frameworks that form the basis of the study. It further assessed the previous literature covered by other scholars that is current and relevant to the study. Chapter three gives the research methodology that included research design that was used in the study, the target population and the sample procedure that was used to determine the sample size and the research instruments used for the study, the data analysis and interpretation methods and the ethics considered while carrying out the study. Chapter five presents the findings of the analyzed data using Tables and Figures besides the means and standard deviation. Chapter five presents the summary of the analyzed data, the discussion of the findings besides the discussion, conclusion and recommendation for the study.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter reviews the literature related to the study. It reviews literature based on the specific research questions; How has Islamic banking affected financial performance of SMEs in Nairobi City; What are the effects of Islamic banking on growth of SMEs in Nairobi City; How has Islamic banking affected credit accessibility among SMEs in Nairobi City; and what are the effects of Islamic banking on financial literacy of SMEs in Nairobi City. In addition, the chapter presents a summary which clearly illustrates the research gap to be filled by this study.

2.2 Islamic Banking and its Effect on Financial Performance of SMEs

Akinyi (2014) defines financial measures of performance as the results of a firm’s operation in ways that can be individually measured and verified. Financial systems play a huge role in seeing the development, growth and success of firms. Most small and medium enterprises (SMEs) look up to financial institutions to enable them performs and grow financially. Financing most definitely has the potential to greatly affect the performance of SMEs.

Yahaya and Lamidi (2015) looked at the financial performance of islamic banking in Nigeria. The study examined the financial performance of Jaiz Bank Plc, which is the only Islamic bank licensed to operate in Nigeria, for over a period of two years (2013 – 2014). The bank managers are better placed to take up measures in an effort to improve the financial profitability of the bank by taking advantage of leverage and growing their banks (Yahaya & Lamidi, 2015).

Osoro and Muturi (2013) on their study on the role of micro financial institutions on the growth of SMEs in Kenya: a case study of micro financial institutions in Kisii County states that bank financing affects financial performance of SMEs positively. The easier credit accessibility is, the higher the financial performance of the SMEs. The study however identified that it is difficult for financial institutions to consider SMEs due to
policies and requirements that have to be met before credit is approved. When bank financing becomes available, the financial performance of business becomes better and hence business growth. Several studies have been carried out on Islamic Banking and its effect on financial performance of SMEs under various factors.

2.2.1 Competitive Advantage

Hove, Sibanda, and Pooe (2014) conducted a study on the impact of Islamic banking on entrepreneurial motivation, firm competitiveness and performance in South-African Small and Medium Enterprises (SMEs) and concluded that Islamic banking has a positive impact on firm competitiveness. Adopting Islamic banking interest free loans enables businesses to gain competitive advantage over those SMEs that lack financial resources mainly due to high interest rates. The provision of these interest free loans also ensures that the SMEs gain market share mostly dominated by large businesses. Competitive edge is usually important for businesses and is usually a factor for measuring financial performance. If a company has competitive advantage over another, it is reported to be performing better financially.

Omerzel and Gulev (2011) conducted a study on knowledge resources and competitive advantage and stressed that the internal capabilities of the firm determine the strategic decisions for external environment competition. In order to turn a unique competence into sustainable competitive advantage, a firm should possess unique resources and also have the capabilities to exploit those particular resources. Plakalović (2015) states that a high level of financial knowledge gives entrepreneurs and their businesses competitive edge over their rivals and this enhance financial efficiency. This will contribute to the improvement in the financial performance of the business.

2.2.2 Profitability and Sales Growth

Omerzel and Gulev (2011) in their study state that firms tend to perform better and attain better profits when they steer their businesses in a good financial direction. Akinyi (2014) states that one measure of SME performance that can be used is sales growth. Sales growth
is the amount by which the average sales of a business or a company’s products or services have grown typically over time.

Nyangoma (2012) conducted a study on credit terms, access to finance and financial performance of SMES in Kampala and noted that SMEs face difficulty in accessing finance from financial institutions, due to lack of financial knowledge, which prevents them from knowing how and where to get this finance on acceptable terms, and the risk associated with their failure to pay back funds. The study findings showed that lack of adequate funding means SMEs experience low incomes that results to low profits. However, any improvement in access to funding from financial institutions by SMEs result to survival, increased sales, higher profitability and low cost of doing business.

2.2.3 Optimal Use of Resources

Plakalović (2015) states that having information about different types of financial products enables and assist them in optimization of available resources by using them in a more efficient way. Not only does having all necessary resources contribute to the financial performance of a business but knowing how to fully optimize these resources is a huge bonus for all businesses. Omerzel and Gulev (2011) states that firms perform better not only because they possess better resources but also because of any distinctive financial knowledge they may have that allows them to make better use of this resources. A company may have valuable and unique resources, but it can only create and sustain competitive advantage if it has the capability to use those resources effectively.

Akinyi (2014) conducted a study on the effect of bank financing on the financial performance of small and medium-sized enterprises in Nairobi County and identified that most micro-enterprises and small companies usually have limited resources of their own. Acquiring financial knowledge and utilization of bank’s credit enables business owners to look for a way to make maximum use of their resources to increase the company’s financial performance.
The growth cycle of a business influences the source of finance that such a business will utilize. Considering small firms with high growth, venture capital, we can say that trade credit, short and intermediate-term financial institution loans and mezzanine fund financing are the most typical sources of finance used. Taking medium-sized and large firms into consideration, then public equity, commercial paper, medium term notes and public debt could be used. However, these two last resources are not adjusted to finance. Kim and Park (2010) in their journal on management titled the effects of open innovation activity on performance of SMEs. The paper mentions that the more sources of readily available fund as a resource to the business the higher the chances of them yielding higher returns. The management team must find a good way to properly use the financial resources available in an effort to yield higher results (Kim & Park, 2010).

2.3.4 Improved Liquidity

Liquidity refers to the ability of a firm to meet its short term obligation as and when they fall due. Islamic banks do not suffer from excess liquidity and therefore they are more cost effective in comparison to the conventional banking system. This therefore enhances their profitability which improves their financial performance (Safiullah, 2010). According to Ahmednoor (2012) any change in the size of Islamic bank’s product will have an effect of the earnings of the bank. According to Ika and Abdullah (2011) Islamic banks are more liquid than CBs and have better liquidity management practices compared to the conventional banks.

According to Abdulle and Kassim (2012) Islamic banks more of the liquid assets as compared to the traditional banking systems and therefore they are less susceptible to the liquidity risks due to the financial crisis. The findings of the study by Rafiuddin and Alam, (2012) indicate that the conventional banks are more profitable compared to the Islamic banks and Islamic banks have high liquidity and low risk in comparison to conventional banks. The literature by Zulfiqar and Anees (2012) indicates that liquidity risk significantly affects the profitability and therefore the financial performance of Islamic banks. Liquidity of any institution determines the source of internal financing which is more attractive than external sources of financing since it is costless compared to external sources of fund.
(Sheikh & Wang, 2011). It is therefore evident from the literature above that Islamic banks have high liquidity compared to the conventional banking systems.

2.3.5 Enhanced Capital Structure

Capital structure refers to an optimal mix of debts and equities of the company to enhance financial soundness. The debts and equity as sources of financing attract different costs. However, since Islamic banking system does not recognize interest on loans, this clearly implies that the capital structures of Islamic banks and the conventional banking systems are different (Al-Kayed, Raihan & Duasa, 2014).

2.3 Islamic Banking and its Effect on Growth of SMEs

Alam (2015) states that SMEs’ limited access to finance reflects the interaction of demand, supply, regulatory, institutional, and other policy factors that are a hindrance for the growth of SMEs. Growth is also hindered in those countries with well-established Islamic banking by the lack of appropriate Islamic finance offerings for SMEs. On average, around 35% of SMEs in Middle East and North Africa (MENA) and Pakistan according to the study are not borrowing money to grow their businesses despite the significant demand due to the lack of Islamic finance. Several studies have been carried out on Islamic banking and its effect on growth of SMEs under various factors.

2.3.1 Starting Capital

Abulkadir (2016) wrote a paper on Islamic Finance in Sub-Saharan Africa - new momentum, new opportunities for growth across the continent and stated that some of the challenges in regions businesses include the lack of financing and the need to have a wider access to financial services. Inadequacy of funds to start or accelerate the growth of a business is a hindrance to the development of many SMEs and entrepreneurs. This can be countered by using Islamic banking as a stimulant for financial inclusion across Africa and it becoming an important source of financial capital for small companies and individuals.
Akinyi (2015) states that access to credit for working capital and long-term investment purpose has been one of the major challenges that SMEs face in their operations whether in Kenya or in other developing countries. The working capital to channel entrepreneurs’ ideas to actions is a huge constraint to SMEs. Using bank financing SMEs can get the funds they need to for start-up and development. In this case Islamic Banking is even better for start-up capital since it has low interest rates that do not steer entrepreneurs to seek informal forms of lending.

Alam (2015) identifies that most SMEs approach banks for working capital requirements. This is very instrumental in the growth of a particular business as it enables a business owner to launch his/her idea and nature it into growth. Nondi and Achoki (2006) conducted a study of financial management problems in small hotels and restaurants in Kenya; found that 26% of these establishments reported lack of working capital as the most serious problem they face in their operations. The study further identified that the provision of working capital by banks would go a long way in improving the financial performance of the business.

2.3.2 Provision of Funds for Increasing Inventory

Alam (2015) also identifies that SMEs approach financial institutions for asset financing. Asset financing is described as the provision of funding by financial institutions to enable businesses to obtain the equipment and supplies they need to grow. Islamic banking can be very influential in providing these funds as the low interest rates they charge translate to more income and profits.

Akinyi (2015) also states that SMEs complain that their growth and competitiveness are constrained by lack of knowledge and access to enough financial resources to expand their businesses by increasing supplies and business infrastructure. The study further noted that that problem exists in many various parts of the world. Bakhshoodeh and Karami (2008) conducted a study on determinants of poor accessibility to micro credits in rural Iran and allocating credit to business owners provides them with capital to buy inputs for the
expansion of their businesses. This has shown to be a good investment and generates good returns for the business owners.

2.3.3 Different Banking Products

Abdulkadir (2016) states that there is a growing demand for the different Islamic banking products that Islamic financial institutions can offer. Kenya Commercial Bank (KCB) recently launched Islamic banking with the aim of tapping into this growing demand for these Islamic financial Products across Kenya and East Africa as a whole. Islamic banking tends to provide these different products for different level of businesses and for different customers according to their repayment ability and this becomes convenient for business owners. They can choose from a variety of options to aid in the growth and expansion of their businesses.

Alam (2015) states that lacking financial knowledge is usually further accelerated by lack of knowledge on the different Islamic financial services and products offered by different Islamic financial institutions. SMEs are generally unaware of the different Islamic financial products that can match up to their needs given how complex Islamic financing models are. The study findings further bring out that Islamic banking involves several products and structures that are in place to accommodate different customers. The SME sector is however underpenetrated by Islamic banking although it demonstrates significant potential. This is due to lack of financial knowledge of these different products.

Alhafi (2015) in the study titled SMEs opportunities for Islamic Banks indicated that most Islamic banks have branding and marketing lapses of SME products since most SMEs are unaware of the availability of such products from their banks. Consequently, Islamic banks have been unable to properly service the SME sector despite having the appropriate products for SMEs. With the right focus and the right use of these processes, products and services, Islamic banks can tap this huge potential.

International Financial Corporation (IFC, 2013) identifies that several Islamic Banks in Pakistan have separate business units/divisions for SMEs, while others provide such services through retail or corporate divisions. These provision of suitable Islamic product
offerings encourages funding for the growth of SMEs. Branding however hinders most SME customers from borrowing funds as they are unaware of the availability of SME financing from banks, especially Islamic products. SMEs in the country lack sufficient knowledge about these products and this limits their ability to utilize them.

2.3.4 Investment and Advisory Services

On a global scale, Islamic banks have been rendering investment and advisory services to the regions’ banks and other financial institutions to build their capacity in SME banking so that they can profitably and sustainably reach out to the SME sector. This is achieved through providing equity finance, lines of credit, risk sharing facilities, trade finance, disseminating best practices, improving processes and products, and streamlining delivery channels (Baumbark & Lawyer, 2013). Availability of the advisory and investment services enhances the competitive edge of the SMEs. According to Muchai (2012) the growth of SMEs in Kenya can be determined by opportunities for profitable investments besides availability capital, labor and their appropriate management.

2.3.5 Asset Based Financing

Islamic banking meets the gap in financing of SMEs through a portfolio of asset based financing. Through provision of asset based financing, clear financing gaps for SMEs that determine the growth can be identified. This is because asset based financing by Islamic banking systems fulfils essential requirements of Islamic financial transaction by ensuring that the financial transaction is part of a real economic activity with a close financial linkage to the financial assets issued to the SMEs. Asset based financing is attained through Murabahah, Ijarah and Salam (Joint World Bank-Islamic Development Bank Policy Report, 2015).

A murabahah is a contract between a financier and a client through which the financier purchases assets required by the client and then sells them to the client at a cost that includes a disclosed profit margin to be paid back, usually in installments. Ijarah, or Islamic leasing, is a transaction through which one party leases an asset such as equipment to be used by a client for an agreed upon rental fee. Another form of Ijarah –Ijarah wa Iqtina – is
a lease to own; a financier leases assets to clients for an agreed rental fee, while only one of the parties unilaterally buys or sells the asset at the end of the lease period. Salam is a forward sale contract in which an advance payment is made for commodities (mainly agricultural crops) to be delivered at a future date. A Salam can thus be utilized to provide working capital to the SMEs and MSMEs.

2.3.6 Equity Based Financing

This form of financing exercises profit and loss sharing between financiers and SMEs which promotes the alignment of their interests, increases risk-sharing, and foster entrepreneurship mainly at the early stage start-ups which rely purely on equity financing for their enterprises. The main forms of equity financing offered by Islamic banks to SMEs are Musharakah, Diminishing Musharakah and Mudharabah (Joint World Bank-Islamic Development Bank Policy Report, 2015).

Musharakah is a partnership agreement established by two or more parties in which all partners provide capital to a joint venture to share its profits and losses. Profits are distributed among partners based on pre-agreed ratios, while losses must be borne by the partners proportionate to their capital contribution. Diminishing Musharakah is a Musharakah agreement where the entrepreneur promises to buy the investment shares of the other partner(s) over time until the entrepreneur owns 100 percent of the venture. Mudharabah is a partnership between a capital provider (Rab-ul-Mal) and an entrepreneur who is acting as fund manager (Mudharib). Profits may be distributed at any pre-agreed ratio, whereas losses are borne by the capital provider.

2.4 Islamic Banking and its Effect on Credit Accessibility among SMEs

According to the International Financial Corporation (IFC, 2013) which conducted a study on Islamic Banking opportunities across Small and Medium Enterprises (SMEs) in Pakistan identified that access to formal financing channels has always been and still is a hindrance to the development and growth of SMEs. One of the reasons for this hindrance is that banks and financial institutions usually hold back from lending to the sector due to lack of confidence in their repayment power among other factors.
Another reason for the lack of access to credit is the lack of financial knowledge amongst entrepreneurs and SME owners. These individuals tend to feel more at ease borrowing from informal lending institutions due to the lack of knowledge or understanding and exposure to banking products and procedures informal environment (IFC, 2013). Their perception of the formal lending institutions processes, products and paperwork may also hinder them from accessing funding. A number of studies have been carried out on Islamic banking and its effect of credit accessibility among SMEs. The studies have been based on various factors.

2.4.1 Low Interest Rates

Walid (2015) undertook a study on the role of Islamic Banking on economic growth in Kenya and stated that as interest rate contribute to higher economic growth. Whenever interest rates are favorable bank lending increases and this contributes to economic growth. Islamic banks generally provide lower bank rates or no bank rates at all but rather use Islamic model of financing business. This makes it easier for businesses to access funds or credit since the periodic repayments are low. The result is increased spending thus enhanced Gross Domestic Product (GDP) and economic growth. Borrowing usually encourages investment from both the local and international level for all types of businesses in the country.

Wajdi Dusuki (2008) undertook a study on banking for the poor: the role of Islamic banking in microfinance initiatives and identified that credit provision and finance accessibility was an issue of concern among entrepreneurs. It also identified that Islamic banking has a great potential to be involved in microfinance programmes to cater for everyone especially those who fall outside the formal banking sector. This is because Islamic banking provided for very low interest rates that could favor people especially the underfunded to invest in their businesses. Bakhshoodeh and Karami (2008) states that most of the people who own small businesses usually consider borrowing money from local money-lenders at very high interest rates that prevent them from getting higher income and
needed capital. They can however make use of Islamic banking which provides loans at low rates which is very convenient to business owners.

Alam (2015) wrote a paper titled Islamic Finance: An opportunity for SME financing and identified that SMEs face the problem of access to financing just like any other business. The study stated that most SMEs lack access to credit, or have very limited access to credit. However various financial institutions and regulatory bodies have claimed that Islamic financing is more stable than conventional financing. This is due to the foundation of Islamic financing which is based on Strong ethical Islamic principles that prohibit interests. Islamic banks and financial institutions are also a good platform for financial inclusion including financing SMEs to improve economic growth.

Hove, Bakhshoodeh and Karami (2008) states in their study that most of the people who own small and medium businesses usually consider borrowing money from local money-lenders at very high interest rates which reduces their operational efficiency. These rates usually prevent them from getting higher income and needed capital as the profits they generate go to the lenders as interests. Sibanda and Pooe (2014) in their study conclusively recommend that SMEs should consider adopting the Islamic banking interest free loans to finance their businesses as this will ensure profitable businesses.

2.4.2 Aligning Islam Banking processes to fit SMEs needs

Alhafi (2015) identifies that designing SME banking models and tailored customer value propositions that target SMEs is a perfect way to increase credit accessibility. The study findings further state that streamlining Islamic banking transaction execution processes like credit approval processes to make the execution of Islamic transactions easier for SMEs is a good way to ensure SMEs access funding that is necessary in their growth and development.

International Financial Corporation (IFC, 2013) states that most SMEs lack financial knowledge about Islamic banking and financial products that suit their needs. This lack of financial knowledge is not only limited to SMEs alone. Employees in Islamic banks are not also adequately staffed with employees well conversant in financial products and they are
often unable to recommend and structure ideal products for clients. The appropriate products structured to fit the needs of different types of SMEs are available but lack of financial knowledge does not allow the SMEs to properly exploit them.

International Financial Corporation (IFC, 2013) also states that Shariah adherence is an important factor for consumers when selecting a bank. In the same way SMEs also strongly prefer Shariah-compliant products. This perception is expected to rise gradually over time due to initiatives undertaken to promote and encourage Islamic banking and raise awareness among the people by the State Bank of Pakistan (SBP) in association with other banks. The study documents the realignment of Islamic financial products and services to be Shariah-compliant is an effort in the right direction that aims at meeting the SME owners’ need. Although its emphasis are on Social responsibility Islamic banking, should resonates with the beliefs of the population

2.4.3 Building Relationships with SMEs

International Financial Corporation (IFC, 2013) in their study have identified that Small and medium enterprise (SME) financing in Pakistan has risen over the past couple of years and is gradually gaining momentum due to initiatives by the State Bank of Pakistan (SBP) and the Pakistan government. Some of these initiatives include the introduction of prudential regulations for Islamic SMEs. Prudential regulation involves promoting the safety and soundness of the firms in this case the SMEs the banks regulate. This is an effort to enhance the relationships between the Islamic banks and the SMEs and make it easier for the businesses to access credit.

Alhafi (2015) stated that Islamic banking focusing on building relationships with SMEs would ensure quick delivery of credit. Islamic banks should put in place the right infrastructure and capabilities to provide SMEs with a good revenue source.

2.4.4 Information Sharing

There is a clear lack of knowledge concerning the Islamic banking products among most SMEs which hinders the uptake of the products. In order to solve this problem, there is
need to provide the SME Islamic finance forum platforms, including standardized documentation, and Shariah standards and operation manuals in multiple languages. According to Doblas-Madrid and Minetti (2009) information sharing contributes towards to the development of the financial system which is an important determinant of SMEs growth.

2.4.5 Credit Terms

Credit terms refers to the standards that commercial banks apply in determining the ability of clients to repay their loans and when it matures. Credit terms help financial institutions in gauging the credit worthiness of the customers while hedging against the risk of loss in case of non repayment from the side of the borrower. Funds for SMEs growth from different financial institutions come with different terms. Credit terms usually state the credit period, the credit limit, the interest rate, and method of calculating interest and frequency of loan installments especially in a non muslim banking institution (Wachira, 2015).

Availability of conducive credit terms influences the uptake of loans among SMEs in Kenya and this positively affects their growth and financial performance. Most SMEs tend to greatly benefit from the Islamic banking system since the credit terms are conducive and convenient. This is because Islamic banks are only allowed to collect the amount equivalent to the loaned principal amount (Aburime & Alio, 2009) and as such, the credit is almost interest free.

2.5 Islamic Banking and its Effect on Financial Literacy of SMEs

According to Hung, Parker, and Yoong (2009) on their study titled defining and measuring financial literacy financial literacy is defined to as the ability of a person or a corporate to use information and skills to manage financial resources effectively for a lifetime of financial well-being. Bhabha, Khan, Qureshi, Naeem, and Khan (2014) on their study on the impact of financial literacy on saving-investment behavior of working women in the developing countries define financial literacy as a combination of knowledge, skill,
awareness, behavior and attitude required to make sound financial assessments and also finally attain individual financial wellbeing.

Financial literacy can be achieved by undergoing financial education which is the process by which people and corporate improve their understanding of financial services, products and concepts, so they are empowered to make informed choices, avoid pitfalls, know where to go for help and take other actions to improve their current short-term and long-term financial well-being (Hung, Parker & Yoong, 2009). Financial literacy can also be described as being a specific form of knowledge, the ability or skills to relate that knowledge, perceived knowledge, good financial behavior, and even financial experiences. Islamic banking has greatly affected the financial literacy of SMEs and several studies have been carried on the topic under different factors.

2.5.1 Financial Behaviors and Attitudes

Antara, Musa, and Hassan (2016) conducted a study on bridging Islamic Financial Literacy and Halal Literacy: The way forward in Halal Ecosystem and stated that Islamic financial literacy affects the attitude of a business owner in adopting Islamic financing. Islamic financial literacy is defined as the degree to which individuals have a set of knowledge, awareness, and skill to comprehend the fundamental of Islamic financial information and services that affect its attitude to make appropriate Islamic financing decisions. Islamic banking allows for people to gain financial literacy that is usually strongly associated with financial behaviors. Islamic banking enhances Islamic financial literacy which is usually assumed to influence the attitude of a person in their financial behaviors. This is especially evident in using financial knowledge to differentiate between conventional financing and Islamic financing and adopting the most appropriate financial behavior.

Xiao, Ahn, Serido, and Shim (2014) conducted a study on earlier financial literacy and later financial performance of college students and stated that financial knowledge is strongly associated with financial behaviors of individuals. Lack of financial knowledge according to the study is associated with risky, borrowing and paying behaviors. Gaining both subjective and objective knowledge was reported to reduce specific risky paying and
borrowing behaviors that individuals engaged in. Hung et. al (2009) stated in his study that financial literacy influences a certain behavior that an individual does. The level of financial literacy between different people is different, and these differences in the level of the literacy will be evident in the different types of behavior that they display.

2.5.2 Financial Decisions

Abdullah and Anderson (2015) in their study in Islamic Financial Literacy among Bankers in Kuala Lumpur stated that financial literacy enables consumers, business owners and investors to have the ability and confidence to make informed choices and to take the appropriate action to improve their financial well-being and that of their businesses. The number of financial products and services are quickly increasing individuals are constantly encouraged to access financial knowledge in order to be more responsible in making important financial decisions. The study explains that the current Islamic financial industry is characterized by different types of financial instruments and assets for not only Muslim stockholders but also the non-Muslim investors to choose from. Gaining knowledge about the differences between these instruments and assets enables investors to take the right steps to better manage their portfolio. These Islamic financial products can be made available to a wider range of people with a clear understanding and appreciation of the unique characteristics and features of Islamic model of banking and its real economic value.

Lusardi (2008) conducted a study on financial literacy: a vital tool for informed consumer choice and identified that when a person is financially illiterate it automatically leads to making poor financial decisions such as excessive borrowing or high-cost mortgage. It also assumed that individuals with Islamic financial illiteracy will result in financial decision mistakes in differentiating between conventional and Islamic financing. Hove et, al (2014) study findings also states that the equipping of SMEs business owners with relevant entrepreneurial skills increase the chances of success of the firms by making proper financial decisions.
Alam (2015) states that SMEs owners lack awareness and knowledge regarding Islamic banking products and what products may suit their requirements. This knowledge can be very influential in making good and appropriate financial decisions. Plakalović (2015) identifies that certain programs of financial education of managers and entrepreneurs mostly provided by financial institutions would give palpable results. Financially aware and literate owners/managers make appropriate financial decisions that contribute to the enhancement of the financial performances of companies.

### 2.5.3 Solving Business Problems

Plakalović (2015) undertook a study on the financial literacy of SMEs managers in the republic of Srpska and found out that most SMEs managers do not use most of the financial analysis tools and the main reason of that was financially illiteracy. With entrepreneurs it is necessary to have financial knowledge that assists to solve business problems and facilitate growth and further advancement. Financial intelligence and knowledge which most banks provide to their customers significantly prevent the demise and closure of SMEs and make successful companies even more successful.

Alam (2015) states that most SME owners lack financial literacy and also pointed out that this makes them oblivious of their banking needs. They prefer informal funding facilities rather than formal financial institutions. They tend to believe that using these informal facilities is more flexible in terms of timing, transactions costs, repayment and documentation. They are however unaware of the existence of Islamic banking products that be customized to fit their needs and aid in solving the different financial business problems that most businesses face.

International Financial Corporation (IFC, 2013) a member of the world bank conducted a study on Islamic Banking opportunities across Small and Medium Enterprises (SMEs) in Pakistan and identified that awareness about Islamic banking services largely determined the level of usage of the banking services amongst SMEs. According to the study which was done in Pakistan, approximately 25% enterprises showed strong interest in Shariah-compliant products. This translates into many businesses and entrepreneurs being financial
illiterate and lacking financial education. This also translates to business owners not having the ability to solve financial business related activities that they may encounter in their daily undertakings.

2.5.4 Financial Knowledge

Financial literacy among SME owners enhances the knowledge of managers on financial management. Financial knowledge of the business owners has an effect on total financing sources of an SME which determine the growth pattern (Huston, 2010). Financial knowledge is enhanced through the practical experiences that managers go through on a day to day basis. Financial knowledge contributes towards awareness among SME managers which significantly affects the growth of the firms. Knowledgeable managers are always on a look out for more accurate information that enhances the decision making abilities. According to Cude (2010), financial knowledge of SME managers can be enhanced through the work experience, higher levels of education, risk appetite, parental occupation, higher age, family income and training attained in classroom teaching.

Financial knowledge also affects the financing decisions of an SME mostly through the capital structure. This is because knowledgeable business management has wide access to information on availability of external sources of financing for their enterprises. Availability of these sources of financing allows finance managers to optimally combine the debts and equities that enhance the capital structure of the SMEs and this has an effect on the growth of an SME (Cude, 2010).

2.5.5 Business Management Skills

Small and Medium Enterprises SMEs managers require financial literacy that enhances the management of the business. SME management team is said to have adequate skills when it is in a position to clearly understand SME life-cycle funding and other financial service requirements; understands legal, regulatory and tax issues as they relate to financial matters; understands the range of legal recourses it can resort to when necessary, and namely, in case of bankruptcy or other situations of financial distress (Messy & Monticone, 2012).
According to Papulova (2007) an SME manager requires the following managerial skills for optimal growth of a firm: technical skills, interpersonal skill, conceptual skills and communication skills. Technical skills represent the manager’s ability to use method for example the break even analysis in planning. Interpersonal skills is about knowing how to lead people, where the manager will has the ability to motivate workers, solve work conflicts and work with people. Conceptual skill on the other is the art of looking at and working with the organization as a small and controllable unit and appropriately relating it with the surrounding environment. Communication skills deal with relates to the way of receiving and disseminating information (Papulova, 2007).

2.6 Chapter Summary
This chapter has looked at the literature from different authors on the research objectives. It covers sections on how Islamic Banking has affected SMEs in terms of their financial performance, the growth of the SMEs; SMEs and their credit accessibility and financial literacy of the SME owners and operators. The next is chapter three which provides research methodology clearly outlining the methods that were used to collect the required data, research design and how data was analyzed.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
This chapter covers the research design that was used in the study. It also covers the target population and the sample procedure that was used to determine the sample size. Lastly it covers the research instruments used for the study, the data analysis and interpretation methods and the ethics considered while carrying out the study.

3.2 Research Design
This study employed a descriptive research design to study the effect of Islamic banking on growth of SMEs in Nairobi: a case study of First Community Bank. The choice of the research design usually must be able to answer the research questions. Descriptive research portrays an accurate profile of people, events or situations. According to Mugenda and Mugenda (2003), a descriptive research design determines and reports the way things are.

Creswell (2013) also observed that a descriptive research design is used when data is collected to describe persons, organizations, settings or phenomena. Maxwell (2012) observed that a descriptive research design is used when data is collected to describe persons, organizations, settings or phenomena. According to Harris, Cartwright, Torok, Holden, Brown, Ogilvy-Stuart and Peacock (2013), it is important to investigate the phenomenon systematically so that the results portray the holistic picture of the lives of the people under investigation.

3.3 Population and Sampling Design

3.3.1 Population
A target population included 4000 SMEs owners that operate within Nairobi Central Business District and all the 103 employees working in different branches of the First Community Bank within Nairobi.
3.3.2 Sampling Design

The sampling design of a study specifies the possibility of a particular sample from being drawn from a whole population.

3.3.2.1 Sampling Frame

The sampling frame of the study included all the First Community Bank employees and all the selected SMEs owners in Nairobi’s Central Business District as the respondents of the study. According to Turner (2003) a sampling frame is the set of items from which a sample size is selected. The sampling frame was derived from the entire target population for this study which were the 4000 SMEs that operate within Nairobi Central Business district and all the 103 employees who work at the Nairobi Branches of the First Community Bank.

3.3.2.2 Sampling Technique

The study adopted cluster sampling whereby a particular portion was selected from the different types of SMEs in Nairobi’s Central Business District and the different Branches of First Community Bank in and around Nairobi. The whole target population was placed in clusters based on the type of business they handle: such as Service operations e.g. hairdressers and electricians; Internet related businesses e.g. cyber cafés and web design; Retail operations e.g. chemists and retail shops; Small-scale manufacturing companies e.g. bakeries and juakali and Professionals that operate in small scale e.g. consultants and lawyers. Then from each cluster respondents were randomly selected to be part of the respondent list for the study. Employees were also selected from the Nairobi Branches. According to Barreiro and Albandoz (2001) cluster sampling is a type of sampling technique whereby the sample was selected from a population that has been divided into units or groups which are a representation of the population.
3.3.2.3 Sample Size

The sample size of the study included 440 respondents. Sample size is defined as a part of the total persons involved on the basis which judgment is made. The sample size \( n \) was determined using the equation below.

\[
n = \frac{N}{1 + \frac{N(e)^2}{n}}
\]

Sample Size for SMEs owners’ was calculated as under:

\[
n = \frac{4000}{1 + \frac{4000(0.05^2)}} = 363 \approx 360 \text{ SMEs owners}
\]

Sample Size for First Community Bank Employees was determined as under:

\[
n = \frac{103}{1 + \frac{103(0.05^2)}} = 81 \approx 80 \text{ employees of First Community Bank}
\]

The total sample size for the study is determined as under:

Total Sample Size \( = \) Sample Size for First Community Bank + Sample Size for SMEs owners

\[
= 360 + 80
\]

\[
= 440 \text{ employees of First Community Bank and SMEs Owners as indicated in Table 3.1 below}
\]

Where \( n \) is the sample size, \( N \) is the population size, and \( e \) is the level of confidence at 95%. The sample size for SMEs owners and First Community Bank employees were:

<table>
<thead>
<tr>
<th>Strata</th>
<th>Population</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMEs owners</td>
<td>4000</td>
<td>360</td>
</tr>
<tr>
<td>First Community Bank employees</td>
<td>103</td>
<td>80</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4103</strong></td>
<td><strong>440</strong></td>
</tr>
<tr>
<td>Genre of SMEs in the CBD</td>
<td>Service operations e.g. hairdressers and electricians</td>
<td>Internet related businesses e.g. cyber cafés and web design</td>
</tr>
<tr>
<td>-------------------------</td>
<td>------------------------------------------------------</td>
<td>-----------------------------------------------------------</td>
</tr>
<tr>
<td>Number of SME owners to be selected</td>
<td>75</td>
<td>75</td>
</tr>
<tr>
<td>First Community Bank Branches in Nairobi</td>
<td>First Community Bank – Kimathi Branch</td>
<td>First Community Bank – Lunga Lunga Branch</td>
</tr>
<tr>
<td>Number of employees to be selected from the bank</td>
<td>16</td>
<td>16</td>
</tr>
<tr>
<td>Total number of respondents</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
3.4 Data Collection Methods
The study collected primary data. The research instruments to be used in the study were questionnaires. The questionnaires were structured and closed ended to enable the researcher create data that is easily quantifiable. The questionnaires were divided into five sections covering the demographic information and the four research questions that the study had chosen to cover.

According to Ngechu (2004) there are many methods of data collection. The choice of a tool and instrument depends mainly on the attributes of the research topic, research questions, objectives, design and expected data and results. According to Saunders, Lewis and Thornhill (2012) a questionnaire includes all methods of data collection in which each person is asked to respond to the same set of questions in a predetermined order.

3.5 Research Procedures
The questionnaires were delivered to the respondents at their various places of work at the SMEs and at the bank at a specific time convenient for both the researcher and the respondents. Research assistants provide guidance and clarifications to the respondents on how to answer the questions. The respondents were given seven days to fill the questionnaires and then they were picked up by the research assistants. The researcher used phone calls to monitor the progress of the filling of the questionnaires once within the week and to answer any questions that the respondents may have.

3.5.1 Pre-testing
A pre-test helps to test the reliability and validity of data collection instruments (Orodho, 2003). The researcher carried out a pilot study as way of determining the reliability and validity of the research instruments. Validity refers to the extent to which an instrument measures what is supposed to measure, for data to be true and accurate it has to be reliable. If a measurement is valid, it is also reliable (Joppe, 2000). The pre-test involved 5 employees at First Community Bank from Aga Khan Diamond Jubilee Hall in Mombasa and 5 SMEs owners from Mombasa. The respondents who took part in
the pre-test were not involved in the final sample size determination. These pre-test revealed important improvements that needed to be made so as to enhance the overall quality of the final collected research data. Areas that needed improvements were identified and improved. In addition, it facilitated the establishment of a proper rapport during the research period as the researcher shall have already made introductions before-hand. The identified 10 staff were randomly chosen by the researcher.

3.6 Data Analysis Methods
The completed questionnaires were edited for consistency and completeness, checked for omissions and errors and then coded and analyzed qualitatively and quantitatively. Qualitatively the data was sought into themes, categories and patterns. This enabled the researcher to make general statements in terms of the observed attributes.

Data from questionnaires were summarized, coded, tabulated and analyzed. Editing was done to improve the quality of data for coding. Coded data was then fed into the statistical package for social sciences (SPSS) version 21 for analysis. This version of SPSS has been selected for analysis since it offers a more user friendly interface and can easily be linked with Microsoft office utility programs. The study derives the mean, frequencies and percentages from the data analysis for each variable. Results of the study were presented in tables, pie charts and bar graphs.

3.7 Chapter Summary
The chapter looks at the research design to be used for the study. The chapter also explains the target population and the sampling design which included the sampling frame and technique to be used to get a sample size to work with for this study. The data collection methods and the research procedures used are expounded and finally the method of data analysis was explained.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
The study sought to determine the effect of Islamic banking on SMEs in Nairobi City. The data was gathered using a questionnaire designed in line with the research questions.

4.1.1 Response Rate
A total of 440 questionnaires were distributed out of which 312 questionnaires were returned giving a response rate of 71%. This response was sufficient and representative of the population and conforms to Mugenda and Mugenda (2003) provision that a response rate of 70% and above is excellent. The finding is shown in Figure 4.1.

![Figure 4.1: Response Rate](image)

4.2 Demographic Information

4.2.1 Gender of the Respondents
The study sought to determine the gender of the respondents. The finding in Figure 4.2 shows that 38% (119) were male while 62% (193) were female. This shows that all genders were included thus presented a good representation for the study.
4.2.2 Highest Level of Education Attained

The respondents were asked to indicate their highest level of education attained. From the responses, majority 29% (917) of the respondents had certificates as the highest qualification, 23% (71) had diplomas, 27% (85) had had bachelor’s degree, and 21% (65) had masters. This shows that the respondents had relevant qualifications and they had ease in addressing the question and provided the correct responses.

Figure 4.2: Gender of the Respondents

Figure 4.3: Highest Level of Education Attained
4.3 Effect of Islamic Banking on Financial Performance of SMEs

Several statements regarding the effect of Islamic banking on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Tables.

4.3.1 Competitive Advantage

Several statements regarding the effect of competitive advantage on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Tables.

From Table 4.1, To a little extent, Islamic banking has facilitated the growth of business market share had a mean of 2.19 with a standard deviation of 1.066, adopting Islamic banking interest free loans enables businesses to gain competitive advantage share had a mean of 2.34 with a standard deviation of 1.410, SMEs have gained market share due to interest free loans had a mean of 2.52 with a standard deviation of 1.506, Islamic banking has improved level of competitiveness on the market had a mean of 2.91 with a standard deviation of 1.153.

Table 4.1: Competitive Advantage

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has facilitated the growth of my business market share</td>
<td>2.19</td>
<td>1.066</td>
</tr>
<tr>
<td>Adopting Islamic banking interest free loans enables businesses to gain</td>
<td>2.34</td>
<td>1.410</td>
</tr>
<tr>
<td>competitive advantage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SMEs have gained market share due to interest free loans</td>
<td>2.52</td>
<td>1.506</td>
</tr>
<tr>
<td>Islamic banking has improved my level of competitiveness on the market</td>
<td>2.91</td>
<td>1.153</td>
</tr>
</tbody>
</table>
4.3.2 Profitability

Several statements regarding the effect of Profitability on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent sections.

From Table 4.2, to a little extent, Islamic banking has shared profits with me at the end of the loan repayment had a mean of 2.42 with a standard deviation of 0.988, Islamic banking has improved financial management skills had a mean of 2.90 with a standard deviation of 1.137. To a moderate extent, Islamic banking has led to growth of SME financially had a mean of 3.50 with a standard deviation of 1.405 and the management team is able to improve the financial profitability had a mean of 3.51 with a standard deviation of 1.142.

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has improved the sales growth rate of my business</td>
<td>1.78</td>
<td>.880</td>
</tr>
<tr>
<td>Islamic banking has shared profits with me at the end of the loan repayment</td>
<td>2.42</td>
<td>.988</td>
</tr>
<tr>
<td>Islamic banking has improved my financial management skills</td>
<td>2.90</td>
<td>1.137</td>
</tr>
<tr>
<td>Islamic banking has led to growth of my SME financially</td>
<td>3.50</td>
<td>1.405</td>
</tr>
<tr>
<td>The management team is able to improve the financial profitability</td>
<td>3.51</td>
<td>1.142</td>
</tr>
</tbody>
</table>

4.3.3 Optimal Resource Use

Several statements regarding the effect of Optimal Resource Use on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the
responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Table

From Table 4.3, the findings of the study reveals that to a no extent the respondents indicated that Islamic banking has facilitated better use of resources had a mean of 1.28 with a standard deviation of 0.453 and Islamic banking has improved the sales growth rate of business had a mean of 1.78 with a standard deviation of 0.880.

Table 4.3: Optimal Resource Use

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has facilitated better use of my resources</td>
<td>1.28</td>
<td>.453</td>
</tr>
</tbody>
</table>

4.3.4 Liquidity

Several statements regarding the effect of Liquidity on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Tables.

From Table 4.4, to a little extent, Islamic banking has provided the required capital for business had a mean of 2.36 with a standard deviation of 1.102, Islamic banking has enhanced accessibility to capital had a mean of 2.44 with a standard deviation of 1.390.

Table 4.4: Liquidity

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has provided the required capital for my business</td>
<td>2.36</td>
<td>1.102</td>
</tr>
<tr>
<td>Islamic banking has enhanced my accessibility to capital</td>
<td>2.44</td>
<td>1.390</td>
</tr>
</tbody>
</table>

4.3.5 Extent to which Islamic Banking affected Financial Performance

The respondents were required to indicate the extent to which Islamic banking affected their organization. The finding shows that 14.4% of the respondents indicated very great
extent, 56.4% indicated great extent, 14.7% indicated moderate extent, 8% indicated little extent and 6.4% indicated no extent.

Table 4.5: Extent to which Islamic Banking affected Financial Performance

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>45</td>
</tr>
<tr>
<td>Great extent</td>
<td>176</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>46</td>
</tr>
<tr>
<td>Little extent</td>
<td>25</td>
</tr>
<tr>
<td>No extent</td>
<td>20</td>
</tr>
<tr>
<td>Total</td>
<td>312</td>
</tr>
</tbody>
</table>

4.4 Effects of Islamic Banking on Growth of SMEs

Several statements regarding the effect of Islamic banking on growth of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent sections.

4.4.1 Starting Capital

Several statements regarding the effect of start up on growth of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent sections. The finding is presented in subsequent sections.

From Table 4.6, to a little extent, Islamic banking has provided with the required capital for my business expansion had a mean of 2.16 with a standard deviation of 1.068, inadequacy of funds affects growth of SMEs had a mean of 2.40 with a standard deviation of 1.438 and Islamic banking has enabled me to make higher incomes due to low interest rates had a mean of 2.32 with a standard deviation of 1.370. To a moderate extent, the respondents
indicated that Islamic banking has ensured equitable access to credit for my business
growth which had a mean of 3.51 with a standard deviation of 1.398

<table>
<thead>
<tr>
<th>Statements</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has provided me with the required capital for my business expansion</td>
<td>2.16</td>
<td>1.068</td>
</tr>
<tr>
<td>Inadequacy of funds affects growth of SMEs</td>
<td>2.40</td>
<td>1.438</td>
</tr>
<tr>
<td>Islamic banking has enabled me to make higher incomes due to low interest rates</td>
<td>2.32</td>
<td>1.370</td>
</tr>
<tr>
<td>Islamic banking has ensured equitable access to credit for my business growth</td>
<td>3.51</td>
<td>1.398</td>
</tr>
</tbody>
</table>

Table 4.6: Starting Capital

4.4.2 Funds for Increasing Inventory

Several statements regarding the effect of Profitability on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Table

The responses from Table 4.7 indicated that, the respondents to a no extent indicated that Islamic banking has offered inventory loans to expand business which had a mean of 1.29 with a standard deviation of 0.455. To little extent, the respondents indicated that Islamic banking is a stimulant for financial inclusion for small business had a mean of 2.51 with a standard deviation of 1.527

<table>
<thead>
<tr>
<th>Statements</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has offered me inventory loans to expand my business</td>
<td>1.29</td>
<td>.455</td>
</tr>
<tr>
<td>Islamic banking is a stimulant for financial inclusion for small business</td>
<td>2.51</td>
<td>1.527</td>
</tr>
</tbody>
</table>

Table 4.7: Funds for Increasing Inventory
4.4.3 Different Banking Products

Several statements regarding the effect of Profitability on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Table

From the findings in Table 4.8, From the responses, the respondents to a no extent indicated that Islamic banking has connected them with other businesses to share business experiences had a mean of 1.78 with a standard deviation of 0.887. To a little extent, Islamic banking has shown me good profitable investment to venture in had a mean of 2.47 with a standard deviation of 1.324, Islamic banking has facilitated my accessibility to greater market had a mean of 2.48 with a standard deviation of 1.374 and Islamic banking has improved my compliance with regulatory provisions had a mean of 2.82 with a standard deviation of 1.154. To a moderate extent, the respondents indicated that Islamic banking has offered me a different banking product from the formal banking products had a mean of 3.58 with a standard deviation of 1.133.

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has connected me with other businesses to share business experiences</td>
<td>1.78</td>
<td>0.887</td>
</tr>
<tr>
<td>Islamic banking has shown me good profitable investment to venture in</td>
<td>2.47</td>
<td>1.324</td>
</tr>
<tr>
<td>Islamic banking has facilitated my accessibility to greater market</td>
<td>2.48</td>
<td>1.374</td>
</tr>
<tr>
<td>Islamic banking has improved my compliance with regulatory provisions</td>
<td>2.82</td>
<td>1.154</td>
</tr>
<tr>
<td>Islamic banking has offered me a different banking product from the formal banking products</td>
<td>3.58</td>
<td>1.133</td>
</tr>
</tbody>
</table>
4.4.4 Extent to which Islamic Banking Affects Growth of SMEs

The respondents were asked to indicate the extent to which Islamic banking affected the growth of their organizations. From the finding, 6.1% of the respondents indicated very great extent, 12.5% indicated great extent, 24% indicated moderate extent, 35.9% indicated little extent and 21.5% indicated no extent.

Table 4.9: Extent to which Islamic Banking Affects Growth of SMEs

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>19</td>
<td>6.1</td>
</tr>
<tr>
<td>Great extent</td>
<td>39</td>
<td>12.5</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>75</td>
<td>24.0</td>
</tr>
<tr>
<td>Little extent</td>
<td>112</td>
<td>35.9</td>
</tr>
<tr>
<td>No extent</td>
<td>67</td>
<td>21.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>312</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

4.5 Islamic Banking and Credit Accessibility among SMEs

Several statements regarding the effect of Islamic banking on credit accessibility among SMEs were identified and the respondents were asked to the extent of agreement with each statement as it relates to their business. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent sections.

4.5.1 Low Interest Rate

Several statements regarding the effect of Profitability on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings.

From the responses in Table 4.10, the respondents to a little extent indicated that Islamic banking has reduced the interest rates paid on borrowed loans which had a mean of 2.11
with a standard deviation of 0.980, diversified collateral for loans has enabled my accessibility to credit had a mean of 2.27 with a standard deviation of 1.189 and Islamic banking has diversified collateral needed for loans had a mean of 2.50 with a standard deviation of 1.167,

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has reduced the interest rates paid on borrowed loans</td>
<td>2.11</td>
<td>.980</td>
</tr>
<tr>
<td>Diversified collateral for loans has enabled my accessibility to credit</td>
<td>2.27</td>
<td>1.189</td>
</tr>
<tr>
<td>Islamic banking has diversified collateral needed for loans</td>
<td>2.50</td>
<td>1.167</td>
</tr>
</tbody>
</table>

4.5.2 Aligning Islam Banking Processes to fit SMEs Needs

Several statements regarding the effect of Profitability on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Table

From the responses in Table 4.11, the respondents to a little extent indicated that Islamic banking has taught on record keeping for business had a mean of 2.16 with a standard deviation of 0.781, Islamic bank teaches on financial knowledge for SME entrepreneurs had a mean of 2.24 with a standard deviation of 1.078, Islamic financing is a stable conventional way of financing had a mean of 2.47 with a standard deviation of 1.128 and Islamic banking has customized its products for businesses had a mean of 2.68 with a standard deviation of 1.129.
### Table 4.11: Aligning Islam Banking Processes to fit SMEs Needs

<table>
<thead>
<tr>
<th>Description</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has taught me on record keeping for my business</td>
<td>2.16</td>
<td>.781</td>
</tr>
<tr>
<td>Islamic bank teaches on financial knowledge for SME entrepreneurs</td>
<td>2.24</td>
<td>1.078</td>
</tr>
<tr>
<td>Islamic financing is a stable conventional way of financing</td>
<td>2.47</td>
<td>1.128</td>
</tr>
<tr>
<td>Islamic banking has customized its products for businesses like mine</td>
<td>2.68</td>
<td>1.129</td>
</tr>
</tbody>
</table>

#### 4.5.3 Building Relationships with SMEs

Several statements regarding the effect of Profitability on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Tables.

From the responses in Table 4.12, the respondents to a little extent indicated that Islamic banking has relationship officers who keep in touch with us continuously had a mean of 2.51 with a standard deviation of 1.045.

### Table 4.12: Islamic Banking and Credit Accessibility among SMEs

<table>
<thead>
<tr>
<th>Description</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has relationship officers who keep in touch with us continuously</td>
<td>2.51</td>
<td>1.045</td>
</tr>
</tbody>
</table>

#### 4.5.4 Extent to which Islamic Banking Affect Credit Accessibility

The respondents were required to indicate the extent to which Islamic banking affected credit accessibility in their organization. From the finding, 34% of the respondents indicated very great extent, 34.6% indicate great extent, 10.9 indicated moderate extent, 4.8% indicated little extent and 15.7% indicated no extent.
Table 4.13: Extent to which Islamic Banking Affect Credit Accessibility

<table>
<thead>
<tr>
<th>Extent to which Islamic Banking Affect Credit Accessibility</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>106</td>
<td>34.0</td>
</tr>
<tr>
<td>Great extent</td>
<td>108</td>
<td>34.6</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>34</td>
<td>10.9</td>
</tr>
<tr>
<td>Little extent</td>
<td>15</td>
<td>4.8</td>
</tr>
<tr>
<td>No extent</td>
<td>49</td>
<td>15.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>312</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

4.6 Effects of Islamic Banking on Financial Literacy of SMEs

Several statements on the effect of Islamic banking on financial literacy of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings.

4.6.1 Financial Behaviors and Attitudes

Several statements regarding the effect of Financial Behaviors and Attitudes on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings.

From the finding in Table 4.14, to a little extent, Islamic banking has changed my attitude to be positive towards loans had a mean of 1.93 with a standard deviation of 1.026 and Islamic financial literacy has aided me to avoid risky ventures had a mean of 2.17 with a standard deviation of 1.146,

Table 4.14: Financial Behaviors and Attitudes

<table>
<thead>
<tr>
<th>Financial Behaviors and Attitudes</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has changed my attitude to be positive towards loans</td>
<td>1.93</td>
<td>1.026</td>
</tr>
<tr>
<td>Islamic financial literacy has aided me to avoid risky ventures</td>
<td>2.17</td>
<td>1.146</td>
</tr>
</tbody>
</table>

46
4.6.2 Financial Decisions

Several statements regarding the effect of Profitability on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Tables.

From the finding in Table 4.15, to a little extent, Islamic banking has improved my knowledge on financial management had a mean of 2.07 with a standard deviation of 0.834, Islamic banking has offered me trainings on financial management had a mean of 2.14 with a standard deviation of 1.247, and Islamic banking has improved my financial decision making processes had a mean of 2.66 with a standard deviation of 1.210.

<table>
<thead>
<tr>
<th>Financial Decisions</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic banking has improved my knowledge on financial management</td>
<td>2.07</td>
<td>.834</td>
</tr>
<tr>
<td>Islamic banking has offered me trainings on financial management</td>
<td>2.14</td>
<td>1.247</td>
</tr>
<tr>
<td>Islamic banking has improved my financial decision making processes</td>
<td>2.66</td>
<td>1.210</td>
</tr>
</tbody>
</table>

4.6.3 Solving Business Problems

Several statements regarding the effect of Profitability on financial performance of SMEs were identified and the respondents were required to the extent of agreement with each statement as it relates to their business. A scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent was used. From the responses, mean and standard deviation were used for ease of interpretation and generalization of findings. The finding is presented in subsequent Tables.
From the finding in Table 4.16, to a little extent, Islamic literacy enables investors manage their portfolio much better had a mean of 2.13 with a standard deviation of 0.806, Islamic banking has improved my business problem solving skills had a mean of 2.35 with a standard deviation of 1.104 and Islamic banking has enlightened me on financial products available on the market had a mean of 2.37 with a standard deviation of 1.266.

<table>
<thead>
<tr>
<th>Table 4.16: Solving Business Problems</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Islamic literacy enables investors manage their portfolio much better</td>
<td>2.13</td>
<td>.806</td>
</tr>
<tr>
<td>Islamic banking has improved my business problem solving skills</td>
<td>2.35</td>
<td>1.104</td>
</tr>
<tr>
<td>Islamic banking has enlightened me on financial products available on the market</td>
<td>2.37</td>
<td>1.266</td>
</tr>
</tbody>
</table>

4.6.4 Extent to which Islamic Banking Affected Financial Performance

The study sought to determine the extent to which Islamic banking affected business performance in the organizations. As indicated in the finding, 32.4% of the respondents indicated very great extent, 33.3% indicated great extent, 17.6% indicated moderate extent and 16.7% indicated no extent.

<table>
<thead>
<tr>
<th>Table 4.17: Extent to which Islamic Banking Affected Financial Performance</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>101</td>
<td>32.4</td>
</tr>
<tr>
<td>Great extent</td>
<td>104</td>
<td>33.3</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>55</td>
<td>17.6</td>
</tr>
<tr>
<td>No extent</td>
<td>52</td>
<td>16.7</td>
</tr>
<tr>
<td>Total</td>
<td>312</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.7 Chapter Summary

This chapter gave a detailed account of the research findings. It showed the response rate, and demographic information of the respondents like their gender and highest level of education. The chapter also highlighted effect of Islamic banking on financial performance of SMEs, effect of Islamic banking on growth of SMEs, Islamic banking and credit accessibility and effect of Islamic Banking on financial literacy of SMEs. The next chapter presents discussions, conclusion and recommendations.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the findings, discussion, conclusions and recommendations of the study based on the research questions of the study. The purpose of this study was to determine the effect of Islamic banking on SMEs in Nairobi City.

5.2 Summary of the Study

The general purpose of the study was to determine the effect of Islamic banking on SMEs in Nairobi City. To reach the purpose of this study sought to answer the following research questions: How has Islamic banking affected financial performance of SMEs in Nairobi City? What are the effects of Islamic banking on growth of SMEs in Nairobi City? How has Islamic banking affected credit accessibility among SMEs in Nairobi City? and What are the effects of Islamic banking on financial literacy of SMEs in Nairobi City?

The study adopted descriptive survey design. This design was applicable to the research since the researcher sought to examine the effect of Islamic banking on growth of SMEs in Nairobi: a case study of First Community Bank. A sample size of 440 was used for the study. Participants were selected using cluster sampling.

The study found out that to a little extent, Islamic banking had facilitated the growth of business market share, provided the required capital for business, improved financial management skills, shared profits at the end of the loan repayment, improved level of competitiveness on the market and enhanced accessibility to capital. SMEs had gained market share due to interest free loans and adopting Islamic banking interest free loans enables businesses to gain competitive advantage share. To a moderate extent, Islamic banking had led to growth of SME financially and the management teams were able to improve the financial profitability.

The study revealed that to a little extent, Islamic banking had provided with the required capital for the businesses expansion, enabled make higher incomes due to low interest
rates, shown good profitable investment to venture in, facilitated accessibility to greater market, a stimulant for financial inclusion for small business and improved compliance with regulatory provisions. To a moderate extent, Islamic banking had ensured equitable access to credit for business growth and offered a different banking product from the formal banking products.

The study established that to a little extent Islamic banking had reduced the interest rates paid on borrowed loan, taught on record keeping for business, teaches on financial knowledge for SME entrepreneurs, diversified collateral for loans, Islamic financing is a stable conventional way of financing, diversified collateral needed for loans, had relationship officers who keep in touch continuously and customized its products for businesses.

The study also found out that to a little extent, Islamic banking had improved knowledge on financial management, literacy enables investors manage their portfolio much better, offered trainings on financial management, financial literacy had aided to avoid risky ventures, improved business problem solving skills, enlightened on financial products available on the market and had improved financial decision making processes.

5.3 Discussion

5.3.1 Effect of Islamic Banking on Financial Performance of SMEs

The study sought to establish whether Islamic banking enhances resource utilization. From the findings, respondents indicated to a no extent that Islamic banking has facilitated better use of resources and had improved the sales growth rate of business. This therefore implies that Islamic banking does not affect resource utilizations and this is likely to have least effect on sales growth of SMEs in Kenya. The finding contradicts with that of Osoro and Muturi (2013) on their study on the role of micro financial institutions on the growth of SMEs in Kenya: a case study of micro financial institutions in Kisii County states that bank financing affects financial performance of SMEs positively.
The respondents were in agreement to a little extent that Islamic banking had facilitated the growth of business market, provided the required capital for business, enhanced accessibility to capital, and improved financial management skills and level of competitiveness on the market. This finding concurs with that of Plakalović (2015) who states that a high level of financial knowledge gives entrepreneurs and their businesses competitive edge over their rivals. This will contribute to the improvement in the financial performance of the business.

The respondents also to a little extent indicated that adopting Islamic banking interest free loans enables businesses to gain competitive advantage share and SMEs have gained market share due to interest free loans. Interest free loans imply that the SME does not incur finance costs related to the sources of funds and this enhances efficiency and effectiveness. This finding is consistent with that of Hove, Sibanda, and Pooe (2014) that Islamic banking has a positive impact on firm competitiveness. Adopting Islamic banking interest free loans enables businesses to gain competitive advantage over those SMEs that lack financial resources mainly due to high interest rates. According to Omerzel and Gulev (2011) indicates that a firm should possess unique resources and also have the capabilities to exploit those particular resources so as to gain unique competitive advantage.

Moreover, the study revealed that to a little extent, Islamic banking has improved level of competitiveness on the market. This is because of its ability to restrict interest charged on loan called Riba. According to Hove, Sibanda, and Pooe (2014) this provision of interest free loans by Islamic banks ensures that the SMEs gain market share mostly dominated by large businesses. Competitive edge is usually important for businesses and is usually a factor for measuring financial performance. If a company has competitive advantage over another, it is reported to be performing better financially.

The findings of the study to a little extent further revealed that Islamic banking has improved financial management skills. It is this improvement in financial management skills that determines the growth and financial performance of an SME. According to Messy and Monticone (2012) SME management team is said to have adequate skills when
it is in a position to clearly understand SME life-cycle funding and other financial service requirements; understands legal, regulatory and tax issues as they relate to financial matters; understands the range of legal recourses it can resort to when necessary, and namely, in case of bankruptcy or other situations of financial distress.

The study also sought to establish whether Islamic banking has had an effect on SMEs market share and from the findings, the respondents to a little extent agreed that SMEs have gained market share due to interest free loans they receive from Islamic banks. The finding concurs with Hove, Sibanda, and Pooe (2014) who indicated that the provision of these interest free loans also ensures that the SMEs gain market share mostly dominated by large businesses. The gaining of this market share is likely to positively translate into large sales revenue which enhances the financial performance of SMEs in Kenya. According to Akinyi (2014) one measure of SME performance that can be used is sales growth ad this refers to the amount by which the average sales of a business or a company’s products or services have grown typically over time.

The study also established that the respondents agreed to a moderate extent that Islamic banking had led to growth of SME financially and the management teams were able to improve the financial profitability. This finding is in line with that of Omerzel and Gulev (2011) that firms tend to perform better and attain better profits when they steer their businesses in a good financial direction. Furthermore, it the study established that management team is able to improve the financial profitability. Improvement of financial profitability by management is contributed by their skills and competencies. This concurs with Plakalović (2015) who states that a high level of financial knowledge gives entrepreneurs and their businesses competitive edge over their rivals and this enhances financial efficiency.

5.3.2 Effects of Islamic Banking on Growth of SMEs

The respondents agreed to a no extent that Islamic banking had offered inventory loans to expand business and had connected them with other businesses to share business
experiences. This finding is in disagreement with that of Alam (2015) who identifies that SMEs approach financial institutions for asset financing and Islamic banking can be very influential in providing these funds as the low interest rates they charge translate to more income and profits.

The respondents also agreed to a little extent that Islamic banking had provided with the required capital. The availability of sufficient capital for the business leads to financial growth and soundness. According to Alam (2015) most SMEs approach banks for working capital requirements which form part of required capital. Abdulkadir (2016) on the other hand indicates that some of the challenges in regions that businesses face include the lack of financing and the need to have a wider access to financial services. Inadequacy of funds to start or accelerate the growth of a business is a hindrance to the development of many SMEs and entrepreneurs.

The respondents further agreed to a little extent that Islamic banking enabled to make higher incomes due to low interest rates. This is because in comparison to the conventional banking systems, Islamic banks offer loans that do not attract interest. This is convenient for SMEs in Kenya. According to Aburime and Alio (2009) Islamic banks are only allowed to collect the amount equivalent to the loaned principal amount.

The findings of the study further indicated that to a little extent, respondents agreed that Islamic banking has shown good profitable investment to venture in. According to Baumbark and Lawyer (2013), Islamic banks have been rendering investment and advisory services to the regions’ banks and other financial institutions to build their capacity in SME banking so that they can profitably and sustainably reach out to the SME sector. This is achieved through providing equity finance, lines of credit, risk sharing facilities, trade finance, disseminating best practices, improving processes and products, and streamlining delivery channels.

The findings of the study also revealed that Islamic banking has facilitated accessibility to greater market. This helps in growing the customer base and in the long run determines the
revenue streams generated. An SME with large customer base is able to benefit from the advantages of economies of scale that accrue from such sizes and this helps in staying competitive in the market place. The finding concur with Plakalović (2015) who indicated that a high level of financial knowledge gives entrepreneurs and their businesses competitive edge over their rivals and this enhances financial efficiency.

The respondents also agreed to a moderate extent that Islamic banking has offered different banking product from the formal banking products. This finding is in agreement with that of Abdulkadir (2016) who states that there is a growing demand for the different Islamic banking products that Islamic financial institutions can offer and Islamic banking tends to provide these different products for different level of businesses and for different customers according to their repayment ability and this becomes convenient for business owners.

The findings of the study further established that Islamic banking has ensured equitable access to credit for business growth. Availability of credit to an SME ensures financial soundness and this is likely to enhance the financial performance. According to Bakhshoodeh and Karami (2008) and established that allocating credit to business owners provides them with capital to buy inputs for the expansion of their businesses. This has shown to be a good investment and generates good returns for the business owners.

5.3.3 Islamic Banking and Credit Accessibility among SMEs

The respondents were in agreement to a little extent that Islamic banking had reduced the interest rates paid on borrowed loan. The findings concurs with Walid (2015) who undertook a study on the role of Islamic Banking on economic growth in Kenya and stated that as interest rate contribute to higher economic growth and established that whenever interest rates are favorable bank lending increases and this contributes to economic growth. Islamic banks generally provide lower bank rates or no bank rates at all but rather use Islamic model of financing business.
Moreover, respondents agreed to a little extent that Islamic banking teaches on record keeping and financial knowledge for SME entrepreneurs and this likely affects their financial literacy. According to International Financial Corporation IFC (2013) most SMEs lack financial knowledge about Islamic banking and financial products that suit their needs. This lack of financial knowledge is not only limited to SMEs alone.

The study established that Islamic banking has diversified collateral for loans among SMEs in Kenya. This finding concurs with that of Walid (2015) that as interest rate contribute to higher economic growth. Whenever interest rates are favorable bank lending increases and this contributes to economic growth. Islamic banks generally provide lower bank rates or no bank rates at all but rather use Islamic model of financing business. This makes it easier for businesses to access funds or credit since the periodic repayments are low.

The finding of the study further established that respondents to a little extent agreed that Islamic financing was a stable conventional way of financing. This is because of the ability to offer interest free loans. According to Sibanda and Pooe (2014) SMEs should consider adopting the Islamic banking interest free loans to finance their businesses as this will ensure profitable businesses. Furthermore, Wajdi Dusuki (2008) revealed that Islamic banking has a great potential to be involved in microfinance programmes to cater for everyone especially those who fall outside the formal banking sector. This is because Islamic banking provided for very low interest rates that could favor people especially the underfunded to invest in their businesses.

The study finding further indicated that Islamic financing had relationship officers who keep in touch continuously and customized its products for businesses. This is consistent with International Financial Corporation (IFC, 2013) states that most SMEs lack financial knowledge about Islamic banking and financial products that suit their needs. This lack of financial knowledge is not only limited to SMEs alone. Employees in Islamic banks are not also adequately staffed with employees well conversant in financial products and they are often unable to recommend and structure ideal products for clients.
The study revealed that Islamic banking has customized its products for businesses and this enhances the choice of the customers bringing about customer satisfaction. According to a study by Abdulkadir (2016) there is a growing demand for the different Islamic banking products that Islamic financial institutions can offer. Kenya Commercial Bank (KCB) recently launched Islamic banking with the aim of tapping into this growing demand for these Islamic financial Products across Kenya and East Africa as a whole. Islamic banking tends to provide these different products for different level of businesses and for different customers according to their repayment ability and this becomes convenient for business owners.

The study also established that Islamic banking has diversified collateral needed for loans. Diversification is an important strategy when it comes to risk reduction. According to Hove, Bakhshoodeh and Karami (2008) most of the people who own small and medium businesses usually consider borrowing money from local money-lenders at very high interest rates.

### 5.5.4 Effects of Islamic Banking on Financial Literacy of SMEs

The respondents were in agreement to a little extent that Islamic banking had improved knowledge on financial management. The finding concurs with Huston (2010) who revealed that financial literacy among SME owners enhances the knowledge of managers on financial management. Financial knowledge of the business owners has an effect on total financing sources of an SME which determine the growth pattern.

The study further revealed that Islamic financing has improved business problem solving skills. According to International Financial Corporation IFC (2013) approximately 25% enterprises show strong interest in Shariah-compliant products. This translates into many businesses and entrepreneurs being financial illiterate and lacking financial education. This also translates to business owners not having the ability to solve financial business related activities that they may encounter in their daily undertakings.
The study also established that Islamic banking has enlightened on financial products available on the market and had improved financial decision making processes. This finding is in line with that of Alam (2015) states that SMEs owners lack awareness and knowledge regarding Islamic banking products and what products may suit their requirements. This knowledge can be very influential in making good and appropriate financial decisions. According to Plkalović (2015) the financial intelligence and knowledge which most banks provide to their customers significantly prevent the demise and closure of SMEs and make successful companies even more successful.

The findings of the study further revealed that respondents to a little extent agreed that literacy enables investors manage their portfolio much better. According to Cude (2010) financial knowledge also affects the financing decisions of an SME mostly through the capital structure. This is because knowledgeable business management has wide access to information on availability of external sources of financing for their enterprises. When SME owners manage their portfolios better, there is a likelihood to reduce the risks which enhances the share returns to the SMEs. Xiao, Ahn, Serido, and Shim (2014) indicate that lack of financial knowledge is associated with risky, borrowing and paying behaviors. Gaining both subjective and objective knowledge reduces specific risky paying and borrowing behaviors that individuals engaged in.

The findings of the study revealed that financial literacy had aided to avoid risky ventures. Different risk behavior of SME owners are shaped by their attitudes and behavior. According to Antara, Musa and Hassan (2016) Islamic banking allows for people to gain financial literacy that is usually strongly associated with financial behaviors. Islamic banking enhances Islamic financial literacy which is usually assumed to influence the attitude of a person in their financial behaviors. This is especially evident in using financial knowledge to differentiate between conventional financing and Islamic financing and adopting the most appropriate financial behavior. This concurs with Abdullah and Anderson (2015) in their study in Islamic Financial Literacy among Bankers in Kuala Lumpur stated that financial literacy enables consumers, business owners and investors to
have the ability and confidence to make informed choices and to take the appropriate action to improve their financial well-being and that of their businesses.

The study further established that Islamic banking offers trainings on financial management. This training is likely to enhance the financial knowledge of SME owners and managers. The finding is in line with Cude (2010) who held that financial knowledge of SME managers can be enhanced through the work experience, higher levels of education, risk appetite, parental occupation, higher age, family income and training attained in classroom teaching.

5.4 Conclusions

5.4.1 Effect of Islamic Banking on Financial Performance of SMEs

The study concludes that the management team of SMEs is able to improve the financial profitability. Furthermore, Islamic banking has led to growth of SMEs financially. Islamic banking has improved the level of competitiveness of SMEs on the market.

5.4.2 Effects of Islamic Banking on Growth of SMEs

The study concludes that Islamic banking offers SMEs with different banking product from the formal banking products. Furthermore, Islamic banking has ensured equitable access to credit for my business growth. Islamic banking has improved SME’s compliance with regulatory provisions.

5.4.3 Islamic Banking and Credit Accessibility among SMEs

The study concludes that Islamic banking customizes its products for SMEs. Nevertheless, Islamic banking has relationship officers who keep in touch with SMEs continuously. Islamic banking has also diversified collateral needed for loans by SMEs.

5.4.4 Effects of Islamic Banking on Financial Literacy of SMEs

The study concludes that Islamic banking has improved SMEs’ financial decision making processes. Islamic banking has enlightened SMEs’ on financial products available on the market. Islamic banking has also improved the SMEs’ problem solving skills.
5.5 Recommendations

5.5.1 Recommendations for Improvement

5.5.1.1 Effect of Islamic Banking on Financial Performance of SMEs

The study recommends that Islamic banks should use new SME banking models to target SMEs. The use of mobile banking to enhance financial inclusion and reduce the cost of administering an account could be a good initial step. The management of SMEs should also seek to enhance their financial performance by increasing their uptake of the Islamic banking products.

5.5.1.2 Effects of Islamic Banking on Growth of SMEs

The study recommends that to utilize Islamic financing schemes in SME financing, one of the problem that should be overcome is asymmetric information. The government can play roles in decreasing the asymmetric information by acting as strategic partner for Islamic bank to identify the potential SMEs. Furthermore, SMEs should enhance their growth by actively substituting the different banking products given by Islamic banking system.

5.5.1.3 Islamic Banking and Credit Accessibility among SMEs

As the SME sector develops, the needs are likely to evolve. Expansion and development of SME operations would lead to the demand for more long-term and financially sophisticated products. Banks should recognize these issues and look to enhance and develop their Islamic product offerings to meet the needs of the SME sector. The study further recommends that the management team of SMEs should seek highly customized financial products from Islamic banks to enhance credit accessibility.

5.5.1.4 Effects of Islamic Banking on Financial Literacy of SMEs

A majority of SMEs do not have sufficient knowledge about finance and management, business skills (such as financial modeling, future planning, and forecasting) and information related to government rules and regulations that impact their functioning.
Furthermore, SMEs should make prudent and rational decisions in connection to Islamic banking products as a way of enhancing their financial literacy.

### 5.5.2 Recommendations for Further Studies

The study found out that Islamic banking play a critical role in SMEs segment of the economy. As such it is important to carry out a study on the potential for Islamic banking in enhancing economic growth.
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APPENDICES

APPENDIX I: QUESTIONNAIRE

EFFECT OF ISLAMIC BANKING ON GROWTH OF SMES IN NAIROBI: A CASE STUDY OF FIRST COMMUNITY BANK

Please answer all questions

SECTION A: DEMOGRAPHIC INFORMATION

1. Name of the organization (Optional) ____________________________

2. Number of years in operations ________________________________

3. What is your position in the organization? ____________________

4. What is your gender? Male [ ] Female [ ]

5. What is your highest level of education attained?
   - Certificate [ ] Diploma [ ]
   - Bachelors Degree [ ] Masters [ ]
   - PhD [ ] Other/Specify: __________________________

6. How long have you worked at this company? __________________

SECTION B: ISLAMIC BANKING AFFECTED FINANCIAL PERFORMANCE

Below are several statements regarding the effect of Islamic banking on financial performance of SMEs. Kindly indicate the extent of your agreement with each statement as it relates to your business. Use a scale of 1-5 where 1= No extent, 2= little extent, 3= great extent and 4=very great extent and 5=N/A for Not Applicable.

<table>
<thead>
<tr>
<th>STATEMENT</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>7. Islamic banking has provided the required capital for my business</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>8. Islamic banking has shared profits with me at the end of the loan repayment</td>
<td></td>
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<td></td>
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<tr>
<td>9. Islamic banking has improved my financial management skills</td>
<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>10. Islamic banking has enhanced my accessibility to capital</td>
<td></td>
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<tr>
<td>11. Islamic banking has improved my level of competitiveness on the market</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>
12. Islamic banking has facilitated the growth of my business market share
13. Islamic banking has improved the sales growth rate of my business
14. Islamic banking has facilitated better use of my resources
15. Islamic banking has led to growth of my SME financially
16. The management team is able to improve the financial profitability
17. Adopting Islamic banking interest free loans enables businesses to gain competitive advantage
18. SMEs have gained market share due to interest free loans

19. In general terms, to what extent has Islamic banking affected financial performance of your organization?

<table>
<thead>
<tr>
<th>Very great extent</th>
<th>Great extent</th>
<th>Moderate extent</th>
<th>Little extent</th>
<th>No extent</th>
</tr>
</thead>
</table>

SECTION C: EFFECTS OF ISLAMIC BANKING ON GROWTH OF SMES

Below are several statements regarding the effect of Islamic banking on growth of SMEs. Kindly indicate the extent of your agreement with each statement as it relates to your business. Use a scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent.

<table>
<thead>
<tr>
<th>STATEMENT</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>20. Islamic banking has facilitated my accessibility to greater market</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>21. Islamic banking has improved my compliance with regulatory provisions</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>22. Islamic banking has provided me with the required capital for my business expansion</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>23. Islamic banking has connected me with other businesses to share business experiences</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>24. Islamic banking has offered me inventory loans to expand my business</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
31. In general terms, to what extent has Islamic banking affected the growth of your organization?

| Very great extent |  |  |
| Great extent      |  |  |
| Moderate extent   |  |  |
| Little extent     |  |  |
| No extent         |  |  |

**SECTION D: ISLAMIC BANKING AND CREDIT ACCESSIBILITY AMONG SMES**

Below are several statements regarding the effect of Islamic banking on credit accessibility among SMEs. Kindly indicate the extent of your agreement with each statement as it relates to your business. Use a scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent.

<table>
<thead>
<tr>
<th>STATEMENT</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>32. Islamic banking has taught me on record keeping for my business</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>33. Islamic banking has diversified collateral needed for loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>34. Diversified collateral for loans has enabled my accessibility to credit</td>
<td></td>
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<tr>
<td>35. Islamic banking has reduced the interest rates paid on borrowed loans</td>
<td></td>
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</tr>
<tr>
<td>36. Islamic banking has customized its products for businesses like mine</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
37. Islamic banking has relationship officers who keep in touch with us continuously

38. Islamic bank teaches on financial knowledge for SME entrepreneurs.

39. Islamic financing is a stable conventional way of financing

40. In general terms, to what extent has Islamic banking affected credit accessibility of your organization?

| Very great extent | [ ] |
| Great extent      | [ ] |
| Moderate extent   | [ ] |
| Little extent     | [ ] |
| No extent         | [ ] |

SECTION E: EFFECTS OF ISLAMIC BANKING ON FINANCIAL LITERACY OF SMES

Below are several statements regarding the effect of Islamic banking on financial literacy of SMEs. Kindly indicate the extent of your agreement with each statement as it relates to your business. Use a scale of 1-5 where 1= No extent, 2= little extent, 3=moderate extent, 4=great extent and 5=very great extent.

<table>
<thead>
<tr>
<th>STATEMENT</th>
<th>1</th>
<th>2</th>
<th>3</th>
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<th>5</th>
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</thead>
<tbody>
<tr>
<td>41. Islamic banking has improved my knowledge on financial management</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>42. Islamic banking has enlightened me on financial products available on the market</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>43. Islamic banking has offered me trainings on financial management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>44. Islamic banking has changed my attitude to be positive towards loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>45. Islamic banking has improved my financial decision making processes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>46. Islamic banking has improved my business problem solving skills</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>47. Islamic financial literacy has aided me to avoid risky</td>
<td></td>
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<td></td>
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</tbody>
</table>
50. In general terms, to what extent has Islamic banking affected financial performance of your organization?

- Very great extent
- Great extent
- Moderate extent
- Little extent
- No extent