

**CREDIT ACCESS FROM COMMERCIAL BANKS AND
GROWTH OF SMALL AND MICRO ENTERPRISES IN
NAIROBI CENTRAL BUSINESS DISTRICT**

BY

EDWARD M. ETEMESI

**UNITED STATES INTERNATIONAL UNIVERSITY-
AFRICA**

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**A Project Report Submitted to the Chandaria School of Business in
Partial Fulfilment of the Requirement for the Degree of Masters in
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**UNITED STATES INTERNATIONAL UNIVERSITY-
AFRICA**

SUMMER 2017

STUDENT DECLARATION

This research project is my original work and has not been presented in any other institution. I agree that this project may be available for reference at the discretion of the university.

Signed: _____ **Date:** _____

Edward M. Etemesi (ID.NO 646382)

I confirm that the work presented in this project has been done by the student under my supervision.

Signed: _____ **Date:** _____

Mr Kepha Oyaro-Supervisor

Signed: _____ **Date:** _____

Dean, Chandaria School of Business

ACKNOWLEDGEMENT

I'm grateful and highly indebted to many outstanding individuals without whom this work would not have been successful. Special gratitude to the Almighty God for the free provision of care, health, and strength he has accorded me, may abundant glory be to God. I'm deeply indebted to my supervisor for his personal commitment, encouragement, availability, patience and tolerance during the many discussions which immensely contributed to the success of the project. To all of you, may our dear Lord richly bless you!

DEDICATION

I dedicate the project work to my entire family, for the support and especially for the encouragement and cheering me up throughout the period. The co-operation, inspiration and spiritual support from my workmates and to my supervisor, for the understanding, patience and guidance. May God bless you all abundantly.

ABSTRACT

Lack of access to credit is a major constraint inhibiting the growth of the SMEs sector. The issues and problems limiting SMEs acquisition of financial services include lack of tangible security coupled with an inappropriate legal and regulatory framework that does not recognize innovative strategies for lending to SMEs. Limited access to formal finance due to poor and insufficient capacity to deliver financial services to SMEs continues to be a constraint in the growth and expansion of the sector. Formal financial institutions perceive SMEs as high risk and commercially not viable and as a result only a few SMEs access credit from formal financial institutions.

The purpose of this study was to analyse the effects of credit access from commercial banks and growth of small and micro enterprises operating in Nairobi Central Business District. The study sought to answer the following research questions; How does collateral requirements by commercial banks affect growth of SMEs? How does financial information required by Commercial Banks at the appraisal stage affect growth of SMEs, How does interest rates charged by Commercial Banks affect growth of SMEs? and how has interest rates capping affected uptake of credits by SMEs?

This study used descriptive survey research design and targeted a population of 838 respondents operating SMEs in the Nairobi Central Business District. A sample size was computed using Yamane (1967) formulae. 225 respondents were interviewed from each shop selected. Questionnaires were used to obtain important information about the population. The study used both primary and secondary data. Primary data is the information the researcher obtained from the field. Primary data was collected using semi-structured questionnaires. The questionnaires were administered using the drop and pick method. Descriptive statistics such as means, standard deviation and frequency distribution was used to analyze the data.

In addition to descriptive statistics regression was conducted to establish the effects of credit access and growth of SMEs. Quantitative technique was used to analyze the closed-ended questions where a computer program (SPSS software) and MS Excel was used. Tables and figures were used appropriately to present the data collected for ease of understanding and analysis. This enabled the researcher to summarize responses for further analysis and to facilitated comparison. Qualitative data was analyzed through content analysis and presented in prose form.

The research established that a unit increase in collateral requirements would lead to a decrease in growth of SMEs by a factor of - 0.417, and that there was strong negative correlation between SMEs growth and development and collateral requirements where the correlation value = 0.653. The effect of financial information on credit access from Commercial Banks showed that a unit change in knowledge on financial information promoted growth of SMEs by a factor of 0.596. The study also found a strong positive correlation between SMEs growth and development and knowledge on financial information where the correlation coefficient was 0.633. E2More so a strong negative correlation between SMEs growth and development and high interest rates was found as the correlation coefficient was - 0.602. Lastly the study also found a strong negative correlation between SMEs growth and development and interest rates capping (correlation coefficient = -0.648).

The study concludes that Collateral requirement has been one of the major hindrances for SMEs access to credit from commercial banks. Majority of the SMEs owners do not have sufficient collateral which is a major requirement for credit access. SMEs encounter problems of raising capital, accessing finance and accessing credit. Majority of the businesses obtain start-up capital from self-financing. Most SME owners lack adequate financial information and literacy to evaluate the cost of credit and the various financial products offered by Banks, most SMEs borrowers borrowed only a small amount of money from the financial institutions. The current banks' lending rates have discouraged many SMEs owners to go for short term and long loans for their businesses, SMEs owners were not satisfied with the lending terms because of high interest rates, short repayment period and long-time taken to process the credit facility. Interest rate capping in Kenya has led to a high degree of exclusion from small loans for SMEs and that Interest rate capping is harmful to SMEs, interest rate caps reduce returns on saving which ultimately reduce both the quality and quantity of investment.

The study recommends for revision of loan interest rates with a view of accommodating all borrowers at different economic levels. Offering of financial training seminars and workshops for entrepreneurship skill acquisition and loan investment and servicing, total nullification of interest capping in Kenya and formulation of repayment schedules that are flexible and highly adjusted to accommodate SME cash flow pattern.

It is important for the government to set up policies that will ease microfinance credit to SME's. These policies should be in line with both the owners of SME's and financial institutions in order to prevent putting hindrances to potential and credit worthy customers who seek to expand or start up a business.

TABLE OF CONTENTS

STUDENT DECLARATION	ii
ACKNOWLEDGEMENT	iii
DEDICATION	iv
ABSTRACT	v
LIST OF TABLES	x
LIST OF FIGURES	xi
LIST OF ACRONYMS	xii
CHAPTER ONE	1
1.0 INTRODUCTION	1
1.1 Background of the Study	1
1.2 Statement of the Problem.....	5
1.3 Purpose of the Study	6
1.4 Research Questions	7
1.5 Significance of the Study	7
1.6 Scope of the Study	8
1.7 Definition of Terms.....	8
1.8 Chapter Summary	9
CHAPTER TWO	11
2.0 LITERATURE REVIEW	11
2.1 Introduction.....	11
2.2 Collateral Pledging in Accessing Credit	11
2.3 Financial Information Asymmetry.....	15
2.4 Interest Rates.....	19
2.5 Interest Rate Capping.....	24
2.6 Chapter Summary	27

CHAPTER THREE	29
3.0 RESEARCH METHODOLOGY	29
3.1 Introduction.....	29
3.2 Research Design.....	29
3.3 Population and Sampling Design.....	29
3.4 Data Collection Methods	32
3.5 Research Procedure.....	33
3.6 Data Analysis Methods	34
CHAPTER FOUR.....	35
4.0 RESULTS AND FINDINGS	35
4.1 Introduction.....	35
4.2 Demographic Information.....	36
4.3 Collateral Requirements.....	39
4.4 Inadequate Financial Information	41
4.5 Interest Rates.....	43
4.6 Interest Rate Capping.....	45
4.7 Correlation	46
4.8 Regression Analysis.....	47
4.9 Chapter summary	49
CHAPTER FIVE	51
5.0 DISCUSIONS, CONCLUSION AND RECOMMENDATIONS.....	51
5.1 Introduction.....	51
5.2. Summary	51
5.3 Discussions	53
5.4 Conclusions.....	60
5.5 Recommendations.....	61
APPENDICES	74
Appendix I: Introduction Letter.....	74
Appendix II: Questionnaire	75

LIST OF TABLES

Table 3.1: Population Distribution.....	30
Table 3.2: Sample Size	32
Table 4.1: Response Rate.....	35
Table 4.2: Reliability Test.....	36
Table 4.3: Age bracket.....	37
Table 4.4: Period which SME has been in Operation	39
Table 4.5: Annual turnover of the SME (Amount in kshs in Millions).....	39
Table 4.6: Effect of collateral requirements on credit access from commercial banks	41
Table 4.7: Effect of financial information on credit access from commercial banks	43
Table 4.8: Effect of interest rates on credit access from commercial banks.....	44
Table 4.9: Effect of interest rates capping on credit access from commercial banks	45
Table 4.10: Correlations.....	47
Table 4.11: Model Summary	47
Table 4.12: Summary of One-Way ANOVA results	48

LIST OF FIGURES

Figure 4.1 : Gender Categories	37
Figure 4.2: Level of Education	38

LIST OF ACRONYMS

GDP:	Gross Domestic Product
IFC:	International Finance Corporation
MFIs:	Monetary Financial Institutions
MSME:	Micro, Small and Micro Enterprises
OECD:	Organisation for Economic Co-operation and Development
ROK:	Republic of Kenya
SME:	Small and Micro Enterprises
CBK :	Central Bank of Kenya

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Small and Micro Enterprises are imperative in advancing monetary development, intensity, business, advancement, and in making new employments (Habibulla, 2010). At present there are three expansive parameters which characterize SMEs. Smaller scale substances are organizations with up to 10 representatives; little organizations utilize up to 50 specialists, while miniaturized scale examined undertakings contain to 250 workers (Wickham, 2008). There is a growing number of empirical studies on small and micro enterprises and the difficulty of SME financing. Certainly, many researchers and policy makers have shown an increasing interest in this area in recent years (Kyaw, 2008; Shen, Shen, Xu, & Bai, 2009). Numbers of studies have revealed that in all economies SMEs are perceived as a growth engine.

Lack of access to credit is a major constraint inhibiting the growth of SMEs sector. The issues and problems limiting SMEs acquisition of financial services include lack of tangible security coupled with inappropriate legal and regulatory framework that does not recognize innovative strategies for lending to SMEs (Richard, 2008). Limited access to formal finance due to poor and insufficient capacity to deliver financial services to SMEs continues to be a constraint in the growth and expansion of the sector. Formal financial institutions perceive SMEs as high risk and commercially not viable and as a result only a few SMEs access credit from formal financial institutions (Raphael, 2012).

Governments throughout the world are nowadays turning their attention to small-scale enterprises. This is because attempts to promote economic progress by establishing large industries have usually failed to improve the lives of the majority of the populations concerned (White Paper on International Development, 2000). Therefore, Small and Micro Enterprises (SMEs) are now viewed as important in even and equitable economic development.

Developed economies have enhanced their credit guarantee schemes for SMEs. In France, for example, the easing of the rules on SME lending in 2014 made it possible for loan guarantee schemes to cover up to 90% of the loan risk, compared with 50–60% previously (Matavire, & Duflo, 2013). In the UK the government guarantees up to 75% of loans to businesses, in Japan 80% and in South Korea 100%. In some cases, governments

have resorted to direct lending to SMEs through public institutions. In Belgium, for example, the Ministry of SMEs provides businesses with pre-fund agreements on the basis of which they can obtain guaranteed loans from banks. Sweden, too, has increased by 50% the lending capacity of the subsidiary SME banks of state-owned business bank Almi (Ingram, 2011). Although governments have attempted to stimulate the supply of finance for SMEs and interest rates continue at an all-time low, SMEs remain reluctant to take up loans because of a lack of demand for their products and services. In addition, in some regions, banks have been reluctant to lend because of increasing financial requirements from regulators.

In Africa and other developing economies, the current situation in relation to SMEs and their finance opportunities remains uncertain. It does seem clear, that the conventional sources of finance are not sufficient to meet the needs of SMEs in the current economic climate. Aryeetey (2013) in their study of informal finance to SMEs in Ghana said that thirty-eight percent of the SMEs interviewed said that access to loans is a limitation. It was deduced that SMEs have inadequate access to capital markets due to the perceived high risk, information barricade plus high costs of intermediation for micro firms.

In South Africa, the future of MSEs is not very bright as the small enterprises are likely to cease operations before the fifth year (Chiliya & Roberts-Lombard, 2012). This makes South Africa to be one of the poorest performers in the informal sector. Lack of financial acumen, weakness in innovation, marketing entrepreneurial flair, practical knowledge and human resource management have been cited as some of the challenges of this sector.

In Ethiopia, perhaps the most important challenge facing policy makers in industrial development is the financing and technological upgrading of the myriad of SMEs that formed the back bone of industry and provide the bulk of employment and income generation. To this end, the current government of Ethiopia has continued to articulate policy measures and programmes to achieve micro, small, and medium enterprises development, through appropriate alternative funding (Kira, 2013).

In Uganda, the performance of the MSEs in the manufacturing sector was considered poor as a result of lack of access to business services and finance despite the significant role they played (Ishengoma & Kappel, 2008). According to Kakuru (2008), in Uganda collateral is up to a tune of 150% of the loan, the repayment period is as short as 24 months, and interest rates range from 23% to 30% per month.

In Kenya, Small businesses lack access to Capital and Money markets. Investors are unwilling to invest in sole proprietorships, partnerships or unlisted companies. As risk perception about small businesses is high, so is the cost of capital and institution credit and when available, requires collateral which in turn makes the business even more vulnerable to foreclosure. Despite efforts by financial institutions and public sector bodies to close funding gaps, Small and Micro Enterprises (SMEs) continue to experience difficulty in obtaining capital. These funding gaps relate to firm size, risk, knowledge and flexibility (Ross, 2007).

In addition, SME borrowing requirements are small and more collateral than SMEs can pledge. Further, the financial institutions may lack expertise in understanding SMEs and also flexibility in terms and conditions of financing that are required by SMEs (PECC, 2003). Small firms have traditionally encountered problems when approaching providers of finance for funds to support fixed capital investment and to provide working capital for the firm's operations.

As per the Kenya Economic Survey 2008 (Republic of Kenya, 2008), out of the aggregate new occupations made, micro, small and micro enterprises (MSME)s made 426.9 thousand new employments out of a sum of 474.5 thousand new occupations out of 543.3 thousand new employments made in Kenya (Economic Survey, 2009). Around the same time, the segment contributed Ksh. 806,170 million of GDP which is 59 percent of aggregate GDP (RoK, 2009). Job creation in this division went up by 5.1 percent in 2011. The increase was 445,900 indicating a higher growth in absolute terms compared to the increase of 437,300 registered in 2010. Analysis by province shows that Nairobi County recorded a 5.4 increase (RoK, 2012).

The SMEs sector is notoriously volatile and experiences a high degree of business closure and shrinkage (Berger, 2006) and as a result the government has been making numerous efforts to assist the development of the SME sectors. The high SMEs mortality rate implies that SMEs are limited in their ability to create long-term sustainable employment and may also be responsible for the greatest number of job and wealth losses (Ayyagari, 2003). Despite the many challenges and difficulties SMEs face, the sector has great potential for increased employment creation (Miller, 2003). Some studies carried out indicate that most SMEs fail as a result of lack of appropriate financing and appropriate financial services (Anthony, 2005).

Joseph, Kofin, Fanyel and Gaeten (2013) noticed that, access to credit is crucial for the development and survival of (SMEs). They watched that policy makers endeavor to seek after budgetary segment policies to move money related mediators to stretch out more credit to SMEs. Access to credit still remains a test to SMEs, particularly those in creating economies and keeps on overwhelming talk both inside business cycle and at the hall of different governments (Joseph, 2013).

Joseph (2013) argued that financial characteristics such as business registration, accurate documentation of transaction and financial activities as well as good business planning have positive correlation with credit accessibility. They observed that asset ownership constitutes a great deal of requirements towards accessing credit from financial institutions as all entrepreneurs who were able to access loans said they own assets such as houses, land, business products and fixed assets which are easily used as collateral depending on the amount of credit being sought (Joseph, 2013). However, access to credit was not tied completely to asset ownership (Joseph, 2013).

European commission report (2013), argued that access to finance is a key determinant for business start-up, development and growth for small and micro size enterprises. It reported that, they have very different needs and faces different challenges with regard to financing compared to large businesses. The report observed that lack of equity capital invested in small firms makes these businesses more irrelevant than other sources such as bank lending and other types of financial products. The current economic environment has brought SMEs needs into particular focus given the significantly lightened credit supply condition arising from the reduced ability and willingness of banks to provide the finance on which this sector is particularly reliant (European Commission report, 2013).

Park, Limand and Koo (2008) identified lack of adequate finance and limited access to credit, rapid technological changes, new laws and regulations and high rate of interest as the major challenges facing SMEs in their financing endeavors. The broad picture that emerges from various surveys of SMEs financing strongly suggests that business owners in South Africa view access to financing as a significant problem for business activity (Turner, 2008). Turner (2008) noted that, there might be a financing gap, despite the various public and private sector initiative to facilitate access to financing.

Antony (2012) argued that despite the potential role of SMEs to accelerate growth and job creation in developing countries, a number of bottlenecks affect their ability to realize

their full potential. Antony (2012) observed that SMEs development is hampered by a number of factors including; seed capital, lack of managerial skills, equipment and technology, regulatory issue and access to international financial markets. The fundamental reasons behind SMEs lack of access to funding can be found in their peculiar characteristics while others argued that SMEs suffer from financing gap because of market imperfection on the supply side (Park, 2008).

Park (2008) further argues that SMEs face financing gaps probably because of a combination of reasons originating from both supply and demand sides. The supply side refers to providers of finance (Financial institutions and investors) while the demand side comprises SMEs which require funding from financial institutions and other providers of finance. The financing gap is most prominent in capital market financing. Most countries including the developed ones have problems in SMEs financing through capital market (Park, 2008). The effect of banking conditions, monetary policy and economic growth on small businesses may change as economic condition change (Storey, 2008). Hans (2008) noted that if their (and likely future) effects likely depend on the prevailing interest rates and economic growth rate and this differs from their past average effects.

SMEs in Kenya experience issues in development because of absence of fund. They barely develop past start-up stage, others leave business at an early stage (Brownwyn, 2009). The research done by Hallberg (2008) uncovers that access to credit is a vital element for improvement of SMEs. They have couple of choices of gaining fund other than depending on their held income to finance their investment. The suggestion in this manner is that SMEs don't have sufficient credit to address their issues at various levels of development. In this manner, a fund hole exists for firms beginning or wishing to extend.

1.2 Statement of the Problem

SMEs face many problems both at start up and their growth phase in many developing countries. Lack of proper skill and the inability to access credit has led to a high failure rate of SMEs in Africa. Approximately 85 in every 100 enterprises fail. This has created a hindrance to most small and micro enterprises growth because they cannot access fund easily and this has made them source and obtain finance from family and friends which is an informal source while medium or large businesses can easily access funds from the bank and other financial institutions who will willingly lend them money because they can easily meet the conditions that they have meet.

The money related issues of SMEs are the underlying driver for the various issues confronted by the SME part. The little and small scale industrialists are for the most part obliged as far as financing because of insufficient modest credit. They fall into the grasp of cash loan specialists who charge high rates of enthusiasm, as an option they get from the merchants of their merchandise, who abuse them by convincing them to offer their items at low costs. SMEs, in Kenya experience issues in development because of absence of back. They scarcely develop past start-up stage. Others leave business at an early stage (Berger, 2006). Despite the SMEs importance in the Kenyan economy, Sessional Paper No. 2 of 2005 indicates that three out of five businesses fail within the first three years of operation (RoK, 2005). The failure of SMEs leads to loss of jobs and consequently increased insecurity, low liquidity in the economy, and decline in economic growth (OECD, 2009).

The study undertaken by Herr (2008) and Newberry (2006) reveals that access to finance is an important ingredient to development of SMEs. They have few alternatives of accessing finance other than relying on their retained earnings to finance their investments. Notwithstanding the financial difficulties faced by SMEs presently in Kenya, alternative sources of funds have to be sought to sustain this important sector.

A number of studies have been conducted in this area. Among the studies done include Rukwaro, (2000) studied influence of credit rationing by MFIS on the operation of SMEs. Mokogi (2003) studied the economic implication of lending of micro-finance institutions on micro and small enterprises. Mutugi (2006) studied the responses of micro finance institutions in Kenya to the turbulent business environment. Muchiti (2009) studied risk management strategies adapted by commercial banks in lending SMEs. None of the foregone studies have undertaken to determine the relationship between access to credit and growth of SMEs in Nairobi. Therefore this study has focused on credit access from commercial banks and growth of small and micro enterprises operating in the Nairobi Central Business District. This study sought to fill this knowledge gap.

1.3 Purpose of the Study

The purpose of this study was to analyse the factors affecting credit access from commercial banks and growth of small and micro enterprises operating in Nairobi Central Business District.

1.4 Research Questions

1.4.1 How does Collateral requirements by commercial banks affect growth of SMEs.

1.4.2 How does financial information required by Commercial Banks at the appraisal stage affect growth of SMEs.

1.4.3 How does Interest Rates charged by Commercial Banks affect growth of SMEs.

1.4.4 How does interest capping by central bank affect growth of SMEs.

1.5 Significance of the Study

The study will be of importance to the following stakeholders:

1.5.1 Commercial Banks Management

The study is invaluable to the management of commercial banks as they will be able to uncover the causes of failure of the Small and Micro Enterprises in repayment of their loans and effective ways of financing the Small and Micro Enterprises, as well as taking appropriate measures against risks facing the Small and Micro Enterprises. The study will provide an insight on the best approaches commercial banks should adopt in financing the Small and Micro Enterprises and how to mitigate against occurrence of nonperforming loans so as to achieve better performance. Managers in the banking industry will find this study significant as it will recommend the best approaches that should be taken when financing Small and Micro Enterprises in to order prevent their organizations from collapsing.

1.5.2 Government

The study will be useful to the government in policy making regarding the financing of the Small and Micro Enterprises through commercial banks. The policy makers will obtain knowledge on the best mechanisms that should be adopted to finance the Small and Micro Enterprises and find ways of curbing the occurrence of non-performing loans from the Small and Micro Enterprises sector. This study will therefore act as a guide in designing appropriate policies that will guide commercial banks in financing the Small and Micro Enterprises.

1.5.3 Scholars and Researchers

The study will also be significant to scholars who will find this study useful as it will provide information on the relationship between the lending to Small and Micro Enterprises

and non-performing loans for commercial banks in Kenya. It will also be of significance to researchers as it will provide basis upon which further studies will be carried out on broad subjects on the relationship between the Commercial Bank Small and Micro Enterprises financing and non-performing loans and it will also provide reference for scholars.

1.6 Scope of the Study

The scope of the study was owners and employees of SMEs operating in Nairobi Central Business District, Nairobi County and aimed at investigating and understanding the factors affecting access of credit from Commercial Banks by SMEs and their growth. The researcher population was 838 enterprises registered with the Nairobi County Council. These provided an adequate population and sample for the study and therefore gave reliable results and findings. The findings were then generalized in the whole SMEs industry because the industry practices are related.

The study was faced by certain limitations including uncooperative respondents, incomplete answering of questionnaires, limited funds and time spent. During the research the researcher encountered some cases of biasness from the respondents. Some of the respondents were not willing to give the true position on issues addressed on the questionnaires. To counter this the researcher made it clear that anything gathered was solely for academic works.

The researchers' sole aim was to personally administer the questionnaires so as to enhance the rate of responses. While the study concentrated on SMEs operating at the Nairobi Central Business District, the researcher encountered a challenge in securing the SMEs owners and employees time considering their busy working schedules which required the researcher to make alternative arrangements to avail themselves for the study off-time hours as well as motivating them on the value of the study. A letter from USIU was also attached to every questionnaire and permission to collect data was sought from the management before the actual data collection. The research covered a period of 6 months.

1.7 Definition of Terms

1.71 Bank

Refers to financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly or through capital markets (Ono, 2005).

1.7.2 Collateral

Collateral is a borrower's pledge of specific property to a lender, to secure repayment of a loan. The collateral serves as protection for a lender against a borrower's default (Newbery, 2006).

1.7.3 Financial Information

Financial information provides information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions (Millinex, 2007)

1.7.4 Financial Markets

Financial are a pillar of civilized society, supporting people in their productive ventures and managing the economic risks they take on (McClelland, 1965).

1.7.5 Interest Rate

An interest rate is the rate at which interest is paid by a borrower for the use of money that they borrow from a lender. Interest rates are normally expressed as a percentage of the principal for a period of one year (Mbonyane,2011).

1.7.6 Small Micro Enterprise

Currently there are three broad parameters which define SMEs micro-entities are companies with up to 10 employees; small companies employ up to 50 workers, whilst micro-sized enterprises contain up to 250 employees (Keister,2008).

1.7.7 Interest Capping

An interest rate ceiling (also known as an interest rate cap) is a regulatory measure that prevents banks or other financial institutions from charging more than a certain level of interest (Mbonyane, 2011).

1.8 Chapter Summary

Lack of access to credit is a major constraint inhibiting the growth of SMEs sector. The issues and problems limiting SMEs acquisition of financial services include lack of tangible security coupled with inappropriate legal and regulatory framework that does not recognize innovative strategies for lending to SMEs. Limited access to formal finance due to poor and insufficient capacity to deliver financial services to SMEs continues to be a constraint in the growth and expansion of the sector. Formal financial institutions

perceive SMEs as high risk and commercially not viable and as a result only a few SMEs access credit from formal financial institutions. In Kenya, Small businesses lack access to Capital and Money markets. Investors are unwilling to invest in sole proprietorships, partnerships or unlisted companies. As risk perception about small businesses is high, so is the cost of capital and institution credit and when available, requires collateral which in turn makes the business even more vulnerable to foreclosure. Despite efforts by financial institutions and public sector bodies to close funding gaps, Small and Micro Enterprises (SMEs) continue to experience difficulty in obtaining capital.

This research is divided into four additional chapters, chapter two covers hypothetical structure, related empirical literature and also the calculated system. Chapter Three contains design research, target populace, sampling procedure, research instruments, legitimacy and unwavering quality of the instruments and information examination. Chapter four entails presentation and analyzing of data while chapter five has findings summary, conclusion and recommendations.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter reviews the past literature on the study. Credit access from commercial banks and growth of small and micro enterprises is critically reviewed. The literature review is guided by the following research questions; How does Collateral requirements by Commercial Banks affect growth of SMEs? How does Financial Information required by Commercial Banks at the appraisal stage affect growth of SMEs? How does Interest Rates charged by Commercial Banks affect growth of SMEs? And how does interest capping by central bank affect growth of SMEs? The chapter addresses each of the four variables at a time and a summary of the literature is developed towards the end of the chapter.

2.2 Collateral Pledging in Accessing Credit

Collateral pledging refers to the extent to which assets are committed by borrowers to a lender as security for debt payment (Gitman, 2003). The assets pledged should be used to recover the principal in case of default. SMEs in particular provide security in form of fixed assets (houses, the car, and anything that could actually bring back the principal) in the event of default on loans (Garrett, 2009). Security for loans must actually be capable of being sold under the normal conditions of the market, at a fair market value and also with reasonable promptness. However, in most banks, in order to finance SMEs and to accept loan projects, the collateral must cover 100% or more, equal to the amount of credit extended or financial product (Mullei and Bokea, 2000).

Sometimes the borrowers divert the funds provided by the lenders for their own personal and private use. Therefore, the collateral requirements when in place can reduce negative consequences that can arise from improper utilization of the funds by SMEs. It is evident that most SMEs are denied and discriminated by the lenders in providing financing. This is because of the high risk associated with them lacking adequate resources to pledge as collateral (Kihimbo, 2012).

Bougheas (2005) contend that collateral is an important prerequisite for SMEs in order to access bank finance. Collateral reduces the riskiness of a loan by giving the financial institution a claim on the tangible asset without diminishing its claim on the outstanding debt. Coco (2000) points out that collateral is the lender's second line of defence.

Collateral can solve problems derived from asymmetries in valuation of projects, uncertainty about the quality of projects and the riskiness of borrowers, and problems related to the cost of monitoring or supervising borrowers' behaviour.

The comfort provided by collateral allows financial institutions to offer credit on favourable terms to SMEs even if uncertainty and information opaqueness characterize the firm. If the bank cannot determine a borrowers' riskiness, then collateral may serve as a screening device to differentiate between good and bad borrowers and to mitigate the adverse selection problem. Investors with low probability of default will reveal themselves by accepting collateral requirements which would be unattractive for borrowers categorised as high risks (Bester, 2007).

Collateral requirements serve as an incentive mechanism because higher collateral enforces a selection of less risky projects (Bester, 2007). This is due to the fact that a lower-risk borrower has a greater incentive to pledge collateral than a high-risk borrower, because of his lower probability of failure and loss of collateral. The willingness of the entrepreneur to pledge collateral positively influences the quality of credit request as perceived by the bank. Borrowers signal the real value and belief in the quality of the project to the bank. Thus, low risk borrowers can signal their status through the provision of collateral, even though literature identifies collateral as a key, contracting tool employed by lenders to reduce the problem associated with asymmetrical information.

According to Stiglitz and Weiss (1981) collateral acts as an indicator of the borrower's creditworthiness. The bank screens firms by offering both loan contracts with higher collateral value with lower interest rates and loan contracts with lower collateral with higher interest rates. Although risk factors may not be readily observable, lower risk borrowers will nonetheless pledge more and better collateral value than riskier borrowers because this pledge is less costly for borrowers who have lower likelihoods of losing the pledged collateral. The probability of losing collateral acts as a disciplinary tool for the borrower. Thus, the pledge of collateral leads to a higher level of effort to satisfy loan conditions and meeting loans obligations, reducing a borrower's default probability. Collateral therefore serves as a tool for resolving moral hazard problems (Aghion & Bolton, 2012).

Gangata and Matavire, (2013) in their study on challenges facing SMEs in accessing finance from financial institutions, found out that very few SMEs succeed in accessing

funding from financial institutions, the main reason being failure to meet lending requirements, chief among them being provision of collateral security. A study was done on challenges faced by Small & Medium Enterprises (SMEs) in obtaining credit in Ghana. Based on the responses received through the questionnaires circulated, it became evident that SMEs in Ghana like most SMEs in other countries are faced with major challenges in accessing credit. These challenges were revealed by the study to include, the inability of SMEs to provide collateral and other information needed by banks such as audited financial statement coupled with the high cost of loan in terms of high interest rates making it extremely difficult to access bank loans (Vuvor & Ackah, 2011).

2.2.1 Tangible Assets Availability

Previous researchers suggest that bank financing will depend on whether the lending can be secured by collateral (Storey, 1994; Berger and Udell, 1998). When other factors are held constant, firms with more intangible assets have limited access to financing, compared to firms with more tangible assets. SMEs have fewer collateralizable assets than large firms. This may partly relate to the stage of growth the firm is in. In the earlier stages of the firm, it may have lower retained profits which may hinder it from purchasing fixed assets compared to the larger firms which have a longer history. Another reason why small firms have a smaller proportion of fixed assets is the capital constraints faced by them. Because of the need to raise large amounts of capital, it becomes difficult for them to acquire substantial fixed assets.

Access to formal finance is also poor because of the high risk of default among SMEs due to inadequate financial facilities (Cook, 2009). Matavire et al., (2013), in their study on challenges facing SMEs in accessing finance from financial institutions; A case of Belaway, Zimbabwe found out that SMEs fail to secure loans because of restrictive requirements of the financial institutions, top among them being lack of collateral. Among their recommendations was that the government should play its role of enabling SMEs to access finance from financial institutions. Makena, et al., (2014), in their study on challenges facing women entrepreneurs in accessing business finance in Kenya: A case of Ruiru Township, Kiambu County, and lack of fixed assets was one of the objectives. However, the study found out that lack of tangible collaterals like land was a greater hindrance to credit accessibility by women entrepreneurs. Among their recommendations was that the government should play its role of enabling SMEs to obtain finance from financial institutions.

2.2.2 Group Guarantees Availability

As indicated by Ono (2005) Small business in Africa can once in a while meet the conditions set by money related organizations, which see SMEs as an unsafe in view of poor certifications and absence of satisfactory data about their capacity to reimburse advances. The money related markets in the greater part of Africa are immature nonetheless thus gives less monetary instruments. Capital markets are in their early stages, shareholding is uncommon and no long-haul financing is accessible for SMEs. Non-bank monetary mediators, for example, Micro Finance Institutions, which could have been of a major help in loaning cash to the little SMEs don't have the assets to catch up their clients when they extend (Hempel, 2007).

Atieno (2008) led a review on SME exhibitions in country regions in focal Kenya and discovered that absence of underwriters by smallholders is ordinarily observed as one of the requirements constraining them to profits by credit offices. In any case, much of the time the get to issue, particularly among formal monetary establishments, is one made by the foundations for the most part through their loaning approaches. This is shown as endorsed least advance sums, entangled application methods and confinements on layaway for particular purposes (Schmidt, 2009).

Oketch (2007) conducted a study on 16 financial institutions to determine the demand and supply of credit to the SMEs sector. The study revealed that the demand and supply for credit have been on the increase since 1991. It also revealed that the demand has only been met by a small percentage of what is required. The study also revealed that although financial institutions lend to prime borrowers with collateral security, there is need for these institutions to increase their lending to SMEs.

2.2.3 Repayment Modes Flexibility

For small scale ventures, solid access to fleeting and little measures of credit is more important, and underlining it might be more suitable in credit programs went for such undertakings. Schmidt and Kropp (2009) contended that the kind of money related organization and its approach will frequently decide the get to issue. Where credit length, terms of instalment, required security and the arrangement of supplementary administrations don't fit the necessities of the objective gathering, potential borrowers won't make a difference for credit even where it exists and when they do, they will be denied get to. Encounter demonstrates that the vast majority of the conditions forced by

formal credit organizations like guarantee prerequisites ought not really restrain smallholders and the poor in acquiring credit (Atieno, 2008).

The poor can utilize the advances and compensate if compelling strategies for payment, supervision and reimbursement have been set up. Accessing contingency funding in form of credit from formal financial institution is not easy and especially within short notice in case of an emergency. According to a survey conducted by Central Bank of Kenya (CBK, 2007), the interest rate charged on a loan is only one part of the cost of the loan. A complete list of charges may include commitment / facility arrangement fees, processing fees, negotiation fees, valuation fee, insurance, appraisal fee and legal fee (CBK, 2007).

2.3 Financial Information Asymmetry

The access to credit information in local lending environments determines the extent to which small enterprises obtain sufficient external financing to exploit profitable projects. The extent to which the business environment inhibits the optimal provision of credit determines the size of the funding gap that small enterprises might face (Berger, 2004). Access to information is important both from the SMEs perspective and from the perspective of the providers of financial services and products. The SMEs require information with which to identify the potential suppliers of the financial products. It requires this information to evaluate the cost of the financial services and products that are being offered. The financial services providers require information with which to evaluate the risk profile of the SMEs applying for finance, and to assess the prospects of the SMEs within the market segment.

One of the problems faced by small firms when attempting to raise finance is information asymmetry in that they cannot prove the quality of their investment projects to the provider of finance. SMEs managers often lack financial sophistication, as they are often product or service specialist, not specialists in the area of finance. Thus, the information asymmetry problem is partly one relating to difficulties in the spheres of communication and credibility. This is compounded by the fact that new or recent start-up businesses may be unable to provide historical data evidenced financial performance track record. Banks in particular rely on past financial performance as an indicator for the future profitability of projects (Tucker & Lean, 2003). Additionally, some small business managers tend to be restrictive when it comes to providing external financiers with detailed information about the core of the business, since they believe in one way or the

other, information about their business may leak through to competitors (Winborg & Landstrom, 2000).

The risks that banks face when they lack necessary and information to distinguish between good and bad borrowers are moral hazards and adverse selection (Jaffee & Russel, 2011); monitoring costs and transaction costs in issuing bank debt, such as costs of application, screening costs and bankruptcy costs (Williamson, 2012). Banks are not interested in granting credit to SMEs because it is particularly difficult to overcome information asymmetries and resulting screening, monitoring, and enforcement problems: clients are poor, have few assets to collateralise, they don't keep records and those who keep the quality of information is unreliable, and give rise to high transaction costs (Binswanger, 1986).

2.3.1 Limited Information on Financial Management

The availability of information in the decision to lend is important because it enables the bank to evaluate the risk-return profile of the loan application and hence set the level and terms of credit to be extended to the borrower. However, according to Gorman et al. (2005) full information about the borrower's project may not always be available. This leads to a situation of information asymmetry, which occurs when one party to the lending transaction has more or better information than the other. Information asymmetry between SME borrowers and banks is reflected in inability of the majority of SMEs to provide up to date reliable financial information and realistic business plans. This increases the cost of lending that banks incur while dealing with these SMEs. It also limits the ability of banks to assess the credit worthiness of the individual SME borrowers. Where information asymmetry exists, literature shows that it may lead to excess demand for credit in traditional credit markets (Jaffe & Russell, 1976). This arises due to credit rationing which results from the risks perceived by lenders because of information insufficiency in evaluating loan applications.

The flow of information in the financial market is crucial for both SMEs and financial providers (Falkena, 2011). In order for SMEs to identify potential supplier of financial services, they require enough information. The financial institutions require information to enable them to evaluate the potential risks associated with the SMEs that apply for bank financing and also to access the location where the same SMEs will be operating and its market segments (Otieno, 2010). Information asymmetries are actually concerned

with the two players in the financial market. In this case, the borrowers on one lender know more about their business cases while the bankers may not know more about it on the other one hand. It entails the lack of timely, accurate, quality, quantity, and complete information regarding the ability of the applicants to repay back the loan and to access financial products from the banking institutions (Bazibu, 2012).

A study by Agostino (2008), conducted on the agricultural sector, pointed out that the failure of the current African market is because of the number of the current agricultural credit problems. The failures of the market mostly occur due to the fact that it is costly to screen credit applicants. The imperfections of the information affect almost all small holder farmers who are in most cases African women.

Gitari, (2012) in her study on factors affecting women entrepreneurs and financial performance in Kenya: a case of Ngara Market, found out that lack of information on who is offering what and the cost of obtaining such services limit them and that high inventory costs are some of the major drawbacks for success by women entrepreneurs. The high cost of running the SMEs is a big threat to the women development due to lack of adequate capital and lack of information on how to access funds to boost the business is also a major threat.

2.3.2 Limited Training on Financial Management

A study by Wagemma (2006) sought to identify critical factors that influence access to bank credit by SMEs. The study indicated that entrepreneurial orientation is a direct determinant of access to credit by SMEs. Further, knowledge-based resources gained from maturation (age), training, previous start up experience and vicariously through entrepreneurial parents were found to be associated with greater levels of entrepreneurial orientation. Overall, these findings support the literature that underscores the primacy of entrepreneurial factors, over the operating environment in facilitating small enterprises' access to bank credit (Wagemma, 2008).

Kumar & Francisco (2005), found a strong education effect in explaining access to financial services in Brazil. They also found that graduates had the least difficulties raising finance from banks. The researchers have given three interpretations for this finding. Firstly, more educated entrepreneurs have the ability to present positive financial information and strong business plans notwithstanding the fact that they have the ability to maintain a better relationship with financial institutions compared to less educated

entrepreneurs. Secondly, the educated managers/owners have the skills to manage the other functions of the business such as finance, marketing, human resources and these skills results to high performance of the business which helps those firms to access finance without any difficulty. The third reason stems from the supply side, where the bankers value higher education level of the owner/manager in the loan approval process as an important criterion. Previous researchers have found positive relationships between previous management experience and business growth, and therefore better placed in accessing finance.

Furthermore, Storey (1994) explains that this is due to the desire of owner/managers to exceed the wage level they sacrificed in becoming self-employed. He emphasizes the positive effect of past experience on small business growth by proposing that owner-managers with previous experience are more likely to avoid costly mistakes than those with no prior experience.

2.3.3 Networks

Networks play a crucial role, especially in relationship lending. Study on relationship lending emphasizes the role of trust on easy access to credit in SMEs. According to Moro & Fink (2013), loan manager trust on a firm will reduce credit constraints and increase accessibility to credit. It is widely agreed that networks are considered as an effective tool to overcome asymmetric information (Dabla-Norris & Koeda, 2008).

Another role of long term relationships documented in Fraser (2013) research revealed such relationships enable creditors to those firms using fund ineffectively by cutting off future lending. For bank financing, Berger & Udell (1995) show that having a multiple relationship with banks help firms to borrow at lower rates and pledge less collateral. In a comprehensive survey on network and accessibility to finance, Kenia, Atieno (2009) pointed out that linkages with financial institutions enable enterprises to access financial services. Interestingly, Hernández-Canovas and Martínez-Solano (2010) found that relationships with banks help European SMEs access debt more easily but SMEs bear higher interest rates if they establish a relationship with only one bank rather than two banks.

Nevertheless, networks or relationships appear to be more important to obtain informal finance and venture capital. Unlike formal creditors, informal creditors do not rely much on official information disclosed by firms such as financial statements or business plans

but on informal information acquired through business relationship with borrowers (Dabla-Norris & Koeda, 2008). For venture capital, investors use social tie to gather private information on finance for start-ups (Shane & Cable, 2002). This view is in accordance with Sengupta's (2011) study that investors not only rely on firm's creditworthiness to finance venture capital or give referral to someone else but trustworthiness also plays an important role. Moreover, networks with lenders, connections with other enterprises and business associations also help to promote access to financial services (Atieno, 2008).

2.4 Interest Rates

SMEs have to pay a higher rate of interest and comply with more restrictive requirements on institutional credit obtained by them, compared to those imposed on their large-scale counterparts (Berger, 2004). In absolute terms, the rates on SME loans are as high as 24-33 per cent, reflecting in part the larger inducement for financial institutions to participate in SME lending (Soita, 2008). Moreover, upwards of four-fifths of SME applicants are required to provide suitable collateral and the preferred security of fixed real estate assets has imposed a difficult requirement on smaller enterprises. Loan terms are typically for 12 months although there is no comparable information on loan rollover rates (Fischer, 2008).

Holt (2004) agrees that in many developing countries, overall interest rates are relatively high to begin with, so that rates charged by micro lending schemes are quite high when the risk premium is added. Many of these micro-institutions claim a high rate of repayment. This is attributable to the informal participatory structures, which create an atmosphere in which debtors respect their obligations. While this phenomenon is certainly true of the better-run institutions, it is not possible to verify whether this is a universal feature. Interest is the premium recovered by the lender after a stated period of time (Amonoo, 2003). Interest rate can be defined as the price lenders expect (and borrowers pay) for exchanging current claims for greater future claims to goods and services. Interest rates represent the cost of money.

From borrowers' point of view, interest is viewed as cost of capital at the time of obtaining a loan. According to Funkor (2000) some of these factors that affect interest rate include high inflation, cost of intermediation, high credit risk, exchange rates, high interbank rate and treasury bill rates. The Neo-classical school of thought maintains that

interest rate is determined by market forces of supply and demand. Autonomous increase in savings reduce the interest rate and the additional cost of capital. Since additional investment contributes to diminishing returns, this will cause a switch from less capital intensive to more capital intensive methods of production (Amonoo, 2013). Ingram (2011) states that interest rates are important because they control the flow of money in the economy. High interest rates curb inflation but also slow down the economy.

2.4.1 Inflation

Low interest rates stimulate the economy, but could lead to inflation. When interest rates are high, people do not want to borrow from the bank because it is more difficult to pay the loans back, and the number of purchase of real assets goes down. While the effects of a lower interest rate on the economy are very beneficial for the consumers. Low interest rates are not beneficial for lenders, who are seeing less of a return on their assets than in times when interest rates are high. The problem of high interest rates is one that is generally associated with Sub-Saharan African financial markets. This is seen as reflecting the absence of competition in the markets. The clearest indicator of the absence of competition in Sub-Saharan African financial markets is the continuing wide spread in interest rates. In general, between 1990 and 2004, the spread which is the difference between lending and deposit rates for many Sub-Saharan African countries was in excess of 12 percentage points and appeared to be widening (Aryeetey, 2005).

While the high rates remain, commercial lending by banks has shrunk in favor of bank holdings of government securities. The prevalence of exorbitantly high real lending rates and the continuing increase in the lending deposit rate margins is particularly worrying. Interest rates have remained high in most countries despite the reforms intended to make the markets more efficient. Thus, interest rates act as a mechanism to avoid bad risk borrowers (Aryeetey, 2005). Interest rates are determined by the maximum expected return to banks rather than being established by supply and demand forces. However, as soon as banks adopt very risk-averse behaviour they may decide to set the charged interest rate below that one maximizing the expected return, since further increases in the interest rate could increase their probability of going bankrupt.

Under such circumstances banks take into account the cost of bankruptcy as well as the changing economic landscape (Stiglitz et al., 1981). Lower lending rates increase financial inclusion by attracting new borrowers and that the elasticity of demand increases

over time (borrowers become more sensitive to pricing over time) (Lydia, 2012). It has been argued that such interest rates can erode surpluses generated by borrowers, leaving them with little net gain. There is also concern that high rates reduce the demand for and uptake of financial services (Dehejia, 2012).

2.4.2 Money Lenders

Helms and Reille (2004) drew on available literature to ask whether and how poor people can afford high interest rates. They put forward a number of arguments that question the extent to which high interest rates necessarily hurt the poor, including the following. The poor generally consider ongoing access to credit more important than the actual cost of the credit; Studies show that clients benefit from microfinance loans, and that they can and do repay loans; The higher costs of credit have not necessarily excluded poor customers; Data from the World Bank indicates leading MFIs have succeeded in reaching large numbers of poor clients; Alternatives to credit tend to be very expensive moneylenders, input suppliers, inflexible and risky local savings circles, or nothing at all; It is common for moneylenders to charge effective interest rates well in excess of 10 percent per month.

In a study by Karlan and Zinman (2008) there is an argument that there has been an assumption among the policy makers of price inelastic demand (meaning the poor are largely insensitive to interest rates). This has provided a foundation for encouraging MFIs to run at sustainable (profitable) interest rates on the basis that it is unlikely to reduce poor people's demand for, or access to credit. To test this assumption, they used an experimental research design to measure the effects of rate fluctuations (of between 50-200 per cent) on uptake of loans by new and existing customers in the case of a South African lender. The study found demand curves were gently sloping downward throughout a wide range of rates below the lenders standard ones, but that demand sensitivity rose sharply at prices above the lenders standard rates. Lower rates indicated more borrowing by poor females in the sample. Higher rates also reduced repayment. They also found that loan price is not the only contracting parameter that might affect demand, and hence MFI profits and targeting.

Liquidity constrained individuals may respond to maturity as well, since longer maturities reduce monthly payments and thereby improve cash flows. In fact the study found that maturity may actually be more influential than price in determining demand for credit if

individuals are more concerned with monthly cash flows than interest expenses. In reviewing this study, Roodman (2011) points out that the subjects of the study lived well above standard poverty lines of \$1 and \$2 a day, and their successes revolved around employment, not entrepreneurship. In a recent study, Dehejia, Montgomery and Morduch (2012) similarly challenge what they see as a widely-held view among experts in the field that interest rates should be set at profit-making levels on the basis that poor customers are primarily concerned with seeking access to credit, but are not necessarily as concerned with getting cheap credit.

They argue that this assumption is questionable because there is very little evidence on how interest rates affect demand for credit in poor communities. In particular, there are unanswered questions about whether poorer customers are deterred from accessing credit because of higher rates, or whether they are able to pay them. In their case study of the micro lender Safe, operating in the slums of Dhaka, they show that poor households are in fact sensitive to price changes. An unexpected price increase, from a real interest rate of around 18 percent per year to a real rate of around 30 per cent per year in line with the prices charged by other major Bangladeshi micro lenders, did affect demand and use of 16 of credit services. Elasticities of loan demand with respect to changes in the interest rate ranged from -0.73 to -1.04 during the twelve months after the price increase.

Moreover, in response to interest rate increases, users altered the way they borrowed taking advantage of Safe Saves flexible lending policy by taking small and more frequent loans and repaying them more quickly. The authors note that it is important to acknowledge that Safe Save did achieve financial stability as a result of the interest rate increase. They suggest that future studies might better explore the heterogeneous impact of interest rate increases on demand for loans.

Rosenberg, Gonzalez and Narain (2009) argue that although interest rates have been the centre of debate about credit pricing, and have received the most attention, they are not the only cost that the poor pay in obtaining loans. They emphasize that it is important to keep in mind the other transaction costs for the borrower, including spending time away from their businesses, transportation expenses, and the negative impact of delays in receiving loan funds. These costs are less easily quantifiable but largely affect the decisions that borrowers make about where they choose to obtain loans. In this sense, interest rates are not the only factor that affect demand for and access to loans.

Operationalizing interest rates in the context of demand for credit by SMEs shows interplay of several factors: the cost of funds, the MFI's operating expenses, loan losses, and profits needed to expand their capital base and fund expected future growth. Many policy makers question why microfinance interest rates remain high even when MFIs receive concessional funds to finance lending. Although micro lenders receive loan funds at concessional rates, they must cost these funds at market rates when they make decisions about interest rates to ensure the sustainability of the institution's operations. Donors provide concessional funds for a particular usage only for a limited period, as do some governments. However, concessional funds cannot be considered a permanent source of funds for MFIs, and provision must be made through interest rates to sustain the lenders' operations. Inflation adds to the cost of microfinance funds by eroding micro lenders' equity. Thus, higher inflation rates contribute to higher nominal credit interest rates through their effect on the real value of equity (Fernando N, 2006).

In an opinion piece, Nobel prize winner Muhammed Yunus (founder of the Grameen Bank), recommended the maximum interest rate charged by MFIs should not exceed the cost of fund meaning the cost that is incurred by the bank to procure the money to lend plus 15 per cent of the fund. However, Gonzalez (2010) argues that although Yunus methodology is appealing in its simplicity, he stresses that costs vary between loan size and with difficult-to-reach clients. Roodman (2011) has similarly stressed that it is very difficult to determine a fair rate by looking at cross-national data, partly because of the different costs associated with providing loans in different regions of the world. He notes that Yunus's ceiling effectively categorizes three quarters of today's creditors as moneylenders and loan sharks.

A study done by Wangui (2011) on the factors that influence demand for credit among small scale investors in Meru showed that education level of an entrepreneur, the number of dependants, and household income are significant factors that influence small-scale entrepreneurs to borrow credit from formal credit institutions. Nyabwala (2010) also conducted a study to investigate the impact of micro financing on performance of small and medium enterprises in Kisumu central business district the findings which include the opinion of poor loan re-payers being willing to borrow at higher interest rates than commercial banks as long as access to credit was provided.

2.5 Interest Rate Capping

Interest rates are key economic aspects that impact the economic growth in a country. Corb (2012) explained that interest rate is a key fiscal tool used by CBK to regulate inflation and enhance economic growth. Regulation of inflation or deflation in Kenya is a role assigned to the Central Bank by the government. The need to regulate the interest charged on credit or any other financial instrument is founded on the necessity to control economic patterns that has great effects to the economy. Controlling and setting of interest rates has huge fiscal implication to the economic development hence the need for rational decision making process within the industry. Many countries have established interest rate ceilings to protect consumers from unscrupulous lenders. Governments often also face political or cultural pressure to keep interest rates low.

A study by Lydia, (2012) revealed that interest rate capping in Germany and France led to a high degree of exclusion from small loans for SMEs in these countries and created a market for illegal lending. According to Kihimbo (2012) capping interest rates in Kenya might solve the high interest rate spreads in the banking sector but will lead to other challenges such as, locking out of SMEs and other “high risk” borrowers from accessing credit as banks will prefer to loan to the government as was experienced in 2016. Straining small banks who effectively have been shut out from the interbank market and now have to mobilise funds at rates higher than what they are getting now and can only lend out within the stipulated margins. Furthermore it is based on an unreasonable premise that the highest extra risk premium in the Kenya market is 4%, banks colluding so as to push up the yields on the treasury instruments, and the emergence of shadow banking systems which may results into inefficiencies in terms of transmitting the effects of policy decision into the economy.

Weak decisions on the interest rates will directly impact the economic performance in all industries but significantly on the financial sectors. Interest rates control is a monetary instrument used in Kenya. When CBK raises its lending rate to financial institution it gestures the same to financial institution, consequently the financial institution do the same. Giovanni (2006) explained out that high interest established by CBK implies that other financial institution shall have to also charge high since they are all profit driven. Access to credit and loans facilities is a major issue to a large portion of the African population. The challenge is much substantial among the underprivileged and especially in rural areas where most people do not have access to banking services as a result of lack

of collateral. Access to credit permits financial leverage which creates wealth (Levine, 1992). Interest rates are typically a topical subject in the micro-finance sector worldwide. The obvious fascinating opinions to extremely subsidized credit in the world's deprived communities is persuasive, specifically in the cause of political expediency. Cheap credit often win quick political opinions for those who support such approaches.

ICPAK (2016) observed that the interest rates charged in Kenya are amongst the highest globally regardless of the banking sector undertaking significant liberalization. The Kenya banking amendment act 2016 put a cap on the interest rates charged on loans and fixed the least rate of interest which such borrowing institutions need pay on deposits held. It also sought to set the highest interest rate chargeable for a loan facility in the country. Additionally, the act specifies that the least interest to be granted on a deposits held in interest earning also to a minimum of 70% of CBR which is the base set and published by the CBK. This bill additionally seeks to modify section 33A of the banking act with the introduction of a new section that provides for interest capping. Capping of interest rates is necessitated by the sensitivity of a skewed loan pricing model employed in the banking sector. This lead rise to the public out-cry that the financial institutions were making considerable profits at the expense of borrowers. The policy change recommended by the banking amendment bill 2016 should be viewed in contradiction of the government's fiscal policy intermediations. It is thus critical that the administration should deal with its rising craving for debt generated from the local market and emphasis on negotiating for cheaper credits from the external markets to evade herding out the private sector out of its domestic market (ICPAK 2016).

Kenyas micro-lending industry is a growing market with the improved disposable income and complementary to the need for credit in the developing market in our economy. The highly sophisticated formal banking sector provides services to established businesses, middle to high-income individuals, but limits services to low-income individuals and micro-businesses almost entirely to the operation of savings accounts. This sector of the market is viewed by the formal Banks as high risk and insufficiently profitable because of the small size of the loans and proportionally high transaction costs. An extensive range of firms have been established over the past 10 years to supply micro-loans to the residents in Kenya.

In the east African context access to financial credit was a rare product for the majority. A combination of factors, including the formal banking industry's shift away from the low

income market, a growing gap between real income and inflation, increasing unemployment and irresponsible lending has fuelled demand and led to the growth of alternative financial service providers, most noticeably money lenders. People borrow from micro lenders for a variety of reasons, including consumption borrowing to finance consumption and borrowing to finance businesses. In general debtors in urgent need of funds, generally have no other financing choices available to them, majority are in a debt twist and must keep turning their debt over and never think in terms of interest rate but in terms of the sum that must be paid back. When the CBK controls the work of the market dynamics, demand and supply cannot interrelate freely in order to establish the equilibrium price and quantity. With an artificial ceiling where the equilibrium price is far above the ceiling price, the distribution of resources is distorted. The importance is that most individuals need finance, but as a result of their circumstances do not qualify at the ceiling interest rate and are hence denied access. As this large segment of the market cannot access funds in the formal economy, they have to resort to the informal economy. By limiting the interest rate chargeable the government may force many actors in this sector underground.

A number of economic and political fuel the practise of interest rate ceilings, such as, to back a specific sector or industry of the economy where market failure is real and where a huge concentration of monetary resources is required. Such market failures as a result of information asymmetries and the failure of financial institutions to distinguish among safe and risky clients, form hostile choices, and moral danger. The interest rate cap is a useful instrument for providing short-term loans to an industry or a sector until it sustains itself (Miller 2013).

Interest rate ceiling can be justified further to defend consumers from abuse by guaranteeing access to loans at rational rate. They protect the general public interest by ensuring reasonable and fair interest rates on loans. On such foundation, interest rate caps are a good method of limiting the availability of credit to some low-income consumers, since they aid prevent social harm. Finally in other rationale, prices charged on loans can be subjective and monopolistic. It thus tends be more than the actual cost of lending, with a lower cap on interest. In nations where high market power limits financial institutions pricing of credit it is acceptable to guard consumers (Timothy , Nathalie M 2014).

Empirical suggestions demonstrate that interest rate capping on credit was effective in Korea since 1956–94 and economic liberalization did not expressively aid in the increase

of financial depth (Timothy, Nathalie 2014). However other studies have argued contrary to the use of interest rate ceiling since it's an unproductive instrument for reducing interest rates in the long-run. They also reduce the access to credits, limit transparency, and reduce product competition and diversity. Furthermore they reduce the demand for loans and impacts negatively the firms' output. Due to interest rate caps the market is distorted and creates adverse selection, as financial firms have a tendency to lend to customers with higher security, thus creating inefficiencies in financial intermediation. As a result, financial institutions limit their lending to those who are in need of it most (Miller 2013).

Nonetheless Banks will remain profitable in the existence of interest rate caps. However such restrictions may cut investments in emerging markets. In cases where capping is set at unprofitable levels, banks may pull out from certain locations such as expensive markets and rural area segments since they cannot cover their expenses, for any low-income debtors with inadequate options of borrowing in the formal market to turn to unlicensed money creditors, perhaps at a higher interests. Controlling and setting of interest rates has a huge fiscal implication to the economic development hence the need for a rational decision making process within the industry. Many countries have established interest rate ceilings to protect consumers from unscrupulous lenders. Governments often face political or cultural pressure to keep interest rates low. For the Kenya case, it's perceived that the signing of the bill into law was more of a political than economic move to woo voters now that the country is in an election mood.

2.6 Chapter Summary

This chapter looks at studies related to the research topic that have been done before based on the research objectives, analysis of credit access from commercial banks and growth of small and micro enterprises operating in Nairobi Central Business District. Access to formal finance is poor because of the perceived high risk of default among SMEs. Collateral requirements by financial institutions have served as an incentive mechanism because higher collateral enforces a selection of less risky projects. A lower-risk borrower has a greater security to pledge collateral than a high-risk borrower, because of his lower probability of failure and loss of collateral. The willingness of the entrepreneur to pledge collateral positively influences the quality of credit request as perceived by the bank. Borrowers signal the real value and belief in the quality of the project to the bank. Thus, low risk borrowers can signal their status through the provision

of collateral, even though literature identifies collateral as a key, contracting tool employed by lenders to reduce the problem associated with asymmetrical information.

The comfort provided by collateral allows financial institutions to offer credit on favourable terms to SMEs even if uncertainty and information opaqueness characterize the firm. If the bank cannot determine a borrowers' riskiness, then collateral may serve as a screening device to differentiate between good and bad borrowers and to mitigate the adverse selection problem. One of the problems faced by small firms when attempting to raise finance is information asymmetry in that they cannot prove the quality of their investment projects to the provider of finance. SME managers often lack financial sophistication, as they are often product or service specialist, not specialists in the area of finance. Thus, the information asymmetry problem is partly one relating to difficulties in the spheres of communication and credibility. Interest rate capping is a useful instrument for providing short-term loans to an industry or a sector until it sustains itself. Interest rate ceiling protects consumers from abuse by guaranteeing access to loans at rational rates. They protect the general public interest by ensuring reasonable and fair interest rate on loans.

It's evident that there has been a number of research projects carried out in the past in relation to micro lending and its impact on the socio-economic aspects of the country and its benefits. For instance Oketch (2007) conducted a study on 16 financial institutions to determine the demand and supply of credit to the SMEs sector. The study revealed that the demand and supply for credit have been on the increase since 1991. It also revealed that the demand has only been met by a small percentage of what is required. The study also revealed that although financial institutions lend to prime borrowers with tangible security, there is need for these institutions to increase their lending to SMEs. Wageman (2006) sought to identify critical factors that influence access to bank credit by SMEs.

However, there are notable research gaps. Anecdotal evidence seems to suggest that there has never been an attempt to find out effects of credit access from commercial banks and growth of small and micro enterprises in the Central Business District, Nairobi County. This study seeks to add more knowledge to this field that is not adequately exhausted. Chapter three will look at the research methodology that will be used in the study to collect and analyse data.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

Part depicts design research and methodology. It presents the research design, the populace and design sampling, data collection methods and analysis, research procedure and chapter summary.

3.2 Research Design

The study employed descriptive survey research design for it portray an accurate profile of situations (Cooper & Schindler, 2003). This was designed to describe the characteristics of a particular phenomenon in a situation. It was used to obtain information concerning the current status of the industry and to survey what exists with respect to the conditions in a situation. According to Orodho (2003) descriptive design is suitable because it is used to obtain information that describes existing phenomena by asking individuals about their perceptions, attitudes, behaviours or values. This design was used since it enabled the researcher collect data across the sampled population using the same instruments at the same time.

A descriptive research determines and reports the way things are and attempts to describe such things as behaviour, attitudes values and characteristics. This is also stated by Gay (2006) that descriptive study determines and reports the way things are and commonly involve assessing attitudes and opinions towards individuals, organizations and procedures. The descriptive survey design also enabled the researcher obtain information concerning the effects of credit access from commercial banks and growth of small and micro enterprises operating in Nairobi Central Business District and assess the opinions of owners and employees of the SMEs in the study area. The independent variables with regard to credit access from commercial bank (collateral requirement, financial information, interest rates charged and interest rate capping by CBK) while the dependent variable is growth of SMEs.

3.3 Population and Sampling Design

3.3.1 Population

Population is defined as a complete set of individuals. And for the purpose of this research the target population should be accessible. Target population as defined by

Frederic (2010), is a universal set of the study of all members; real or hypothetical set of people, events or objects to which an investigator wishes to generalize the result. The accessible population is the population in research to which the researchers can apply their conclusions (Thorn hill, 2009). This population is a subset of the target population and is also known as the study population. It is from the accessible population that researchers draw their samples. Kothari (2003) suggests that for descriptive studies ten percent of the accessible population is enough. The population of this study was the 838 SMEs operating with the Central Business District Nairobi.

Table 3.1: Population Distribution

SMEs	Frequency	Percentage
Beauty shops and boutiques	284	35
Electronics and accessories	167	20
Tours and travels/logistics	79	9
Small consulting firms	154	18
Pharmaceuticals	87	10
Catering firms	67	8
Total	838	100

Source: Nairobi County Council, (2016)

3.3.2 Sampling Design

Sampling design is a working plan which specifies the populace frame, sample size and selection, and estimation method in detail. The objective of the sampling design is to know the characteristic of the population (Saunders, Lewis & Thornhill, 2010).

3.3.2.1 Sampling Frame

A sample is a smaller group or sub-group obtained from the accessible population (Mugenda & Mugenda, 2007). Subgroup for this study was carefully selected so as to be representative of the whole population with the relevant characteristics. Each member or case in the sample is referred to as subject, respondent or interviewees. Sampling is a procedure, process or technique of choosing a sub-group from a population to participate in the study (Ogula, 2005). It is the way toward selecting various people for a review in a manner that the people chose speak to the huge gathering from which they are chosen.

3.3.2.2 Sampling Technique

Sampling was done to some elements of populace so that conclusions about the entire populace can be drawn. The ultimate test of a sample design is how well it represents the characteristics of the population it purposes to (Thorn hill, 2009). This research employed a stratified random sampling technique dividing population in groups or strata such as owners, employees and the employee's offspring's. Stratified random sampling was preferred since every SME would have an opportunity of being sampled.

3.3.2.3 Sample Size

A sample frame is a smaller number of cases drawn from the total population (Ingule & Gatumu, 1996). Sampling is important as it saves on expenses and time that could have been used in studying the entire population (Robson, 2002).for the purpose of the study the sample frame was based on the population of owners and employees in SMEs firms within Central Business District Nairobi. A sample size was computed using Yamane (1967) formulae below

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

Where, N is the total number of SMEs firms operating with the Central Business District Nairobi, and e is the error or confidence level. The conventional confidence level of 95% was used to ensure a more accurate result from the sample. Based on this, the error term would equal to 0.05. Using the total population of 838 and error margin of 0.05, the sample size was calculated as follows.

$$838/1+ (838 \times 0.0025)$$

$$838/3.095$$

$$n= 271$$

Hence, out of the total population of 838 SMEs firms, a sample size of 271 was taken.

Table 3.2: Sample Size

SMEs	Frequency	Percentage	Sample size
Beauty shops and boutiques	284	35	93
Electronics and accessories	167	20	55
Tours and travels/logistics	79	9	24
Small consulting firms	154	18	50
Pharmaceuticals	87	10	27
Catering firms	67	8	22
Total	838	100	271

3.4 Data Collection Methods

Data collection encompassed measurement procedures that involved asking questions to respondents. These included both interviews and questionnaires. Schindler (2003) recommends the use of questionnaires in descriptive studies because self-administered typically cost less than personal interviews and sample accessibility is easy. The researcher can contact participants who might also be inaccessible, careful consideration where the participants can take more time to collect facts, talk with others or consider replies at length than is possible in an interview and finally in terms of anonymity where the surveys are typically perceived as more impersonal, providing anonymity than other communication modes (Thorn hill, 2009).

Questionnaires were used to obtain important information about the population. According to Sproul (1998), a self-administered questionnaire is the only way to elicit self-report on people's opinion, attitudes, beliefs and values. The questionnaire contained both closed and a few open-ended questions. Primary data is the information the researcher obtained from the field.

The questionnaires were administered using drop and pick method. The questionnaires were used because they allowed the respondents to give their responses in a free environment and help the researcher gather information that was not have been given out has interviews being used.

The questionnaire had four parts, (a) background information b) opinions based on the three variables c) the dependent variable questions. The first part of the questionnaire was used to gather the respondentst demographic information. This included gender, age, and educational level among others. The second part of the questionnaire included items on the effects of credit access from commercial banks and growth of small and micro enterprises. A 5 point Likert-type response scale ranging from 5 strongly agree to 1 strongly disagree was used to determine the effects of credit access from commercial banks and growth of SMEs. The questionnaires were developed based on the research objectives.

3.5 Research Procedure

After obtaining permission from United States International University Africa, the researcher then visited The National Commission for Science, Technology and Innovation (NACOSTI) to obtain permission to carry out the study. The researcher then pilot tested the questionnaire to test the validity of the questionnaire. A small number of 5 respondents from the shops were used to fine tune the questionnaire to ensure that it will collect the required data to answer the specific questions to solve the research problem. This helped in ensuring the questionnaire is free from errors or ambiguity.

The researcher made a budget for the materials to be used during data collection and purchase materials before the actual data collection. The date and time for collecting data was carefully planned. The researcher distributed questionnaires and interview guides to owners and the employees of SMEs at their respective job places. The researcher used drop and pick method to give the respondents adequate time to fully work on the instruments. The researcher engaged a research assistant who helped in collecting data from the respondents. On completion, the researcher collected the questionnaires from the participants.

Qualitative data was collected by use of the open-ended questions. The data was used to gain an understanding of underlying reasons, opinions, and motivations. Qualitative Research is also used to uncover trends in thought and opinions, and dive deeper into the problem. Quantitative data was collected through the structured questions. This data was used to quantify the problem by way of generating numerical data or data that can be transformed into useable statistics. It was used to quantify attitudes, opinions, behaviors, and other defined variables and generalize results from a larger sample population.

3.6 Data Analysis Methods

Data analysis is the process of cleaning, transforming, analyzing, and modelling data gathered in a research. Data analysis models that was used in the research include both quantitative and qualitative techniques (Yates, Moore, & Daren, 2008). Quantitative technique was used to analyze the closed-ended questions where a computer program (SPSS software) and MS Excel was used. Tables and figures were used to appropriately present the data collected for ease of understanding and analysis. This enabled the researcher to summarize responses for further analysis and to facilitate comparison. Qualitative data was analysed through content analysis and presented in prose form. Quantitative data was also analyzed using Multiple Linear Regression Model.

The general form of the Multiple Linear Regression Model is;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

Where,

Y: the dependent variable (Growth of SMEs) expressed as a linear combination of independent variables X_1 , X_2 and X_3

β_0 : The regression constant i.e. $Y = \beta_0$ when $X_1, X_2, X_3, \dots, X_k = 0$

β_1 : Coefficient of collateral requirements (independent variable X_1)

β_2 : Coefficient of financial information (independent variable X_2)

β_3 : Coefficient of interest rates (independent variable X_3)

e: Error term

Linear regression analysis was used to estimate the coefficients of a linear equation and the Independent variables that best predict the value of the dependent variable. From this model, test of significance at 5% significant level was conducted on the various variables of this study using coefficient of determination (R^2), correlation coefficient (R), F-test and ANOVA table in order to check the significant of the data analyzed.

CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter presents the analysis and interprets the findings obtained from the field based on the objective of the study. The objective of the study was to analyse credit access from commercial banks and growth of small and micro enterprises operating in Nairobi Central Business District. Descriptive statistics was used to discuss the findings of the study. To this end, the study administered questionnaires to 271 respondents out of which 225 filled and returned. The findings are presented in tables, pie chart, bar graph, figures, and interpretation thereafter.

4.1.1 Response Rate

The total questionnaires issued to respondents were 271 respondents from which 225 were fully filled and returned representing a response rate of 93.3%. This response rate was sufficient to make conclusions for the review. The response rate was illustrative. As indicated by Mugenda and Mugenda (1999), a response rate of more than 50% is satisfactory for examination and announcing; a rate of 60% is great and a reaction rate of 70% and over is sufficient. In regard of the evidence, the response rate was sufficient to conduct the research.

Table 4.1: Response Rate

	Questionnaires Administered	Questionnaires filled & Returned	Percentage
Respondents	271	225	83.03

4.1.2 Reliability Analysis

In order to establish the reliability of the questionnaires Cronbach's Alpha Coefficient of reliability which measures the internal consistency was used. Cronbach's alpha was calculated by application of SPSS for reliability analysis and the aim was to ascertain the correctness of the data gathered. According to Zinbarg (2005), Cronbach's alpha is a coefficient of reliability that gives an unbiased estimate of data generalizability.

The value of the alpha coefficient ranges from 0-1 and a higher value show a more reliable generated scale. Cooper & Schindler (2008) has indicated 0.7 to be an acceptable reliability coefficient. The table below shows that the interest rates capping had the highest reliability ($\alpha = 0.925$) followed by collateral requirements ($\alpha = 0.875$), then Knowledge on financial information ($\alpha = 0.808$) and interest rates ($\alpha = 0.778$). This shows all four scales were reliable as their reliability values exceeded the prescribed acceptability threshold of 0.7 for Cronbach Alpha tests. The value of the alpha coefficient ranges from 0-1 and a higher value show a more reliable generated scale. Cooper & Schindler (2008) has indicated 0.7 to be an acceptable reliability coefficient. The table below shows that the interest rates capping had the highest reliability ($\alpha = 0.925$) followed by collateral requirements ($\alpha = 0.875$), then Knowledge on financial information ($\alpha = 0.808$) and interest rates ($\alpha = 0.778$). This shows all four scales were reliable as their reliability values exceeded the prescribed acceptability threshold of 0.7 for Cronbach Alpha tests.

Table 4.2: Reliability Test

Scale	Cronbach's Alpha	Number of Items	Comment
Collateral Requirements	0.875	5	Reliable
Knowledge On Financial Information	0.808	4	Reliable
Interest Rates	0.778	4	Reliable
Interest Rates Capping	0.925	6	Reliable

4.2 Demographic Information

This section investigated the respondent's demographic data. Specifically, the areas researched on include gender distribution, highest level of education, age category, period of operation and SMEs annual turnover.

4.2.1 Gender Category

Participants indicated their gender category. This was sought in view of ensuring gender involvement in this study. Results are analysed in Table 4.3. Results obtained show that

majority of the respondents as shown by 57.3% were males whereas 42.7% were females. This implies that SMEs in Nairobi County are mostly owned by male this calls for women empowerment on entrepreneurship.

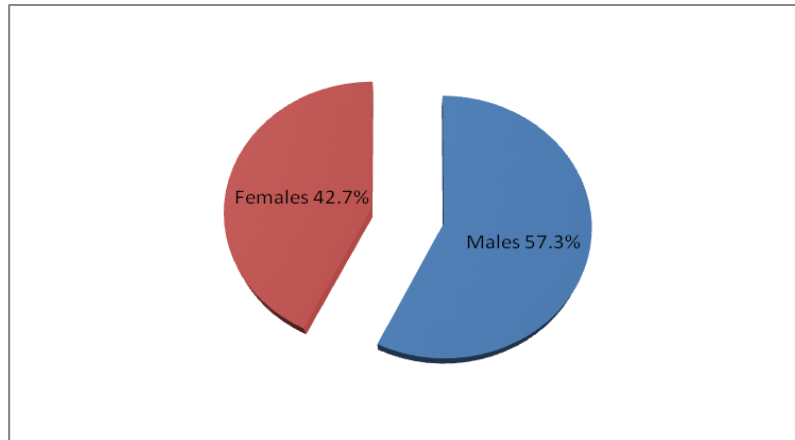


Figure 4.1: Gender Categories

4.2.2 Age Bracket

Respondents of different age set are perceived to hold dissimilar opinion of various issues. To ensure that opinions from all age groups were encapsulated in this research, respondents were requested to specify their age group. Results are analysed in Table 4.4. Results obtained show that majority of the respondents as shown by 27% were aged between 36 -40 years 23% of the respondents were aged between 36 to 40 years, 21% of the respondents were aged between 26 to 30 years, 15% of the respondents were aged between 20- 25 years while 14% of the respondents were aged Above 40 years. This implies that respondents were fairly distributed in terms of their age.

Table 4.3: Age Bracket

Age bracket	Frequency	Percentage
20- 25 years	34	15
26-30 years	48	21
31 -35 years	60	27
36 -40 years	52	23
Above 40 years	31	14
Total	225	100

4.2.3 Highest level of Education

Personal level of education is associated with individual ability to respond to various issues or challenges and redress of the same. In view of ascertaining respondent's ability to respond to research questions and responders were requested to indicate their highest level of education achieved. Results are analysed in figure 4.5. Results obtained show that most of the respondents as shown by 47.6% held diploma level 28.9% of the respondents indicated degree while 23.6% of the respondents indicated post graduate. This shows participants had good education and could respond to research questions well.

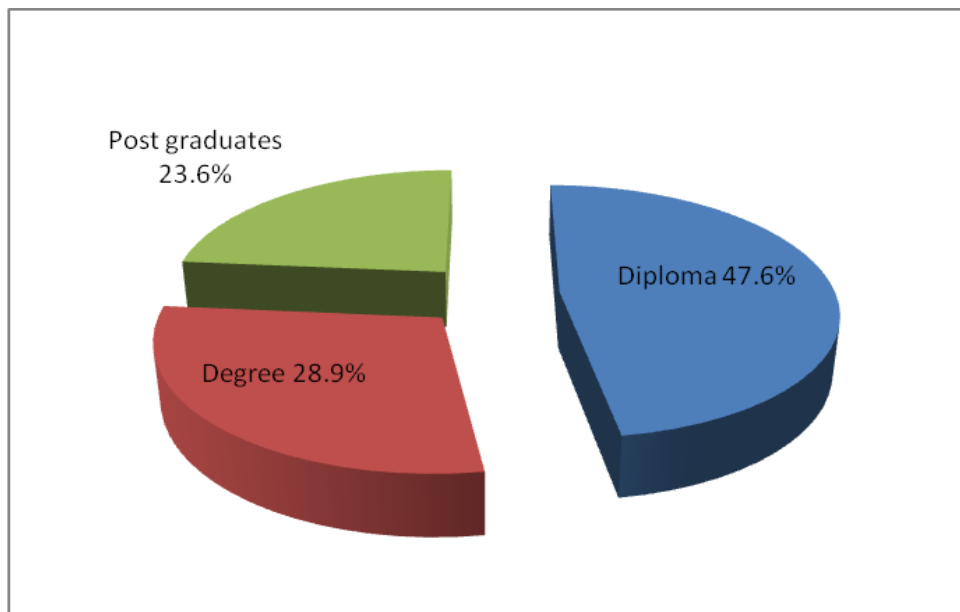


Figure 4.2: Level of Education

4.2.4 Period which SME has been Operation

The study sought to determine the period which SME had been in operation as shown below. From the analysis, 34.7% of participants showed SME had been in operation for a period of 8-10 years, 28.9% of participants showed SME operation for more than 10 years 20.9% indicated SME operation for a period of 3-7 years 11.1% indicated a period of 1-3 years 4.4% indicated the SME had been in operation for not more than year. This implies that considerable number of SMEs had been in operation for a considerable period of time which implies that they were in a position to give credible information relating to this study.

Table 4.4: Period Which SME Has Been In Operation

Period	Frequency	Percentage
Less than one	10	4.4
1-3 years	25	11.1
3-7 years	47	20.9
8-10 years	78	34.7
Above 10 years	65	28.9
Total	225	100

4.2.5 Annual Turnover of the SME (Amount in Kshs Millions)

The study sought to establish the annual turnover of the SME. Results are analysed in Table. 4.7. From the finding, 37.8% of the respondents indicated ksh 100,000, 28.9% of the respondents indicated over ksh 200, 000, 23.6% of the respondents indicated ksh 50, 000 and 9.8% of the respondents indicated below ksh 50, 000.

Table 4.5: Annual turnover of the SME (Amount in kshs in Millions)

	Frequency	Percentage
Below Ksh 50, 000	22	9.8
Ksh 50, 000	53	23.6
Ksh 100,000	85	37.8
Over Ksh 200, 000	65	28.9
Total	225	100

4.3 Collateral Requirements

This section investigated the effect of collateral requirements on credit access from commercial banks

4.3.1 Effect of Collateral Requirements on Credit Access from Commercial Banks

The research sought to establish the extent to which respondents agreed with the following statements relating to effect of collateral requirements on credit access from commercial banks. Results were analysed in Table 4.8

From the results, majority of respondents agreed that costs associated with the collateralization process like legal fees, stamp duty, valuation, insurance etc. discourage borrowing by SMEs from commercial banks (mean = 4.45 Std deviation =0.74), Stringent credit terms imposed by Banks discourage potential borrowers from approaching banks for financing (mean = 4.25 Std deviation =0.79) inability of SMEs to pledge tangible security inhibits their access to credit facilities offered by banks (mean = 4.14 Std deviation =0.17), lack of fixed assets is a hindrance to many SMEs access to credit from commercial banks (mean =3.96, Std deviation = 0.33), duration taken to register and create a charge on the security pledged to a bank discourages SMEs from borrowing from commercial banks, (mean = 3.85 Std deviation =0.84) and that inability of SMEs to access loans from banks one created by the financial institutions mainly through their lending policies (mean = 3.87 Std deviation =0.37).

The findings are in support of the research by Rahman, Davanzo & Sutradhar, (2006) that Collateral requirements for SME loans are higher than for consumer loans, because SMEs' credit risk is usually more difficult to evaluate. SMEs tend to be more vulnerable to economic and political shocks relative to corporate clients, and this would justify an extra layer of security from an SME borrower.

Table 4.6: Effect of Collateral Requirements on Credit Access from Commercial Banks

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std deviation
Inability of SMEs to pledge tangible security inhibits their access to credit facilities offered by Banks	3.5%	5.2%	8.4%	47.3%	35.6%	4.14	0.17
Lack of fixed assets is a hindrance to many SMEs access to credit from Commercial Banks	4.1%	2.4%	7.4%	48.4%	37.7%	3.96	0.33
Costs associated with the collateralization process like legal fees, stamp duty, valuation, insurance etc discourage borrowing by SMEs from Commercial Banks	2.8%	3.9%	6.8%	59.4%	27.1%	4.45	0.74
Duration taken to register and create a charge on the security pledged to a bank discourages SMEs from borrowing from commercial banks.	3.5%	7.2%	8.9%	57.8%	22.6%	3.85	0.84
Stringent credit terms imposed by Banks discourage potential borrowers from approaching Banks for financing	1.7%	7.6%	6.7%	63.2%	20.8%	4.25	0.79
Inability of SMEs to access loans from Banks is one created by the financial institutions mainly through their lending policies	3.5%	5.2%	8.4	47.3%	35.6%	3.87	0.37

4.4 Inadequate Financial Information

This section investigates the effect of financial information on credit access from commercial banks

4.4.1 Effect of Financial Information on Credit Access from Commercial Banks

The research sought to establish the extent to which respondents agreed with the following statements relating to effect of financial information on credit access from commercial banks. Results were analysed in Table 4.11

From the results, majority of respondents agreed that SMEs in Africa can rarely meet the conditions set by financial institutions which include provision of financial information regarding their businesses (mean = 4.36, std deviation = 0.35), most of SMEs fear going for credit from commercial banks based on the many hidden charges (mean = 4.21, std deviation = 0.02) most SMEs owners lack adequate financial information and literacy to evaluate the cost of credit and the various financial products offered by banks (mean = 4.11, std deviation = 0.37) inadequate information from banks in the form of prescribed minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes discourages SMEs owners from approaching commercial banks for loans (mean = 3.98 std deviation = 0.74) and that SMEs require information with which to identify the potential suppliers of the financial products, (mean = 3.92, std deviation = 0.27) the study also revealed that granting of loans or credit to SMEs is still a major problem as many of SMEs are unable to access such funds.

Also, there is the problem of information between the loan provider and loan receiver as to the availability and cost. The study revealed that most SMEs borrowers borrowed only a small amount of money from the financial institutions since they were only eligible to access such amounts given the criteria set by the institutions and also because they were reluctant to take out large amounts that they may not be able to repay. Such small amounts can only have so little impact on SMEs financial performance. The findings are in support of the research by Kashyap, Stein & Wilcox, (2013) The lack of quality information was the biggest SME-specific hindrance and obstacle to SME lending.

Table 4.7: Effect of Financial Information on Credit Access from Commercial Banks

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std deviation
Most of SMEs fear going for credit from commercial banks based on the many hidden charges	1.3%	3.8%	8.3%	50%	36.6%	4.21	0.02
Inadequate information from Banks in the form of prescribed minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes discourages SME owners from approaching Commercial Banks for loans	1.6%	4.2%	11.3%	47.1%	35.8%	3.98	0.74
SMEs in Africa can rarely meet the conditions set by financial institutions which include provision of financial information regarding their businesses	3%	7.5%	18.1%	57.6%	13.8%	4.36	0.35
SMEs require information with which to identify the potential suppliers of the financial products.	2.3%	4.4%	7.1%	53.3	32.9	3.92	0.27
Most SME owners lack adequate financial information and literacy to evaluate the cost of credit and the various financial products offered by Banks	2.4%	5.2%	5.6%	48.7%	38.1%	4.11	0.37

4.5 Interest Rates

This section investigates the effect of interest rates on credit access from commercial banks

4.5.1 Effect of Interest Rates on Credit Access from Commercial Banks

The research sought to establish the extent to which respondents agreed with the following statements relating to effect of interest rates on credit access from commercial

banks. Results are analysed in Table 4.10. From the results, majority of respondents agreed that interest rates charged by commercial banks are relatively high for and unsustainable for SMEs most businesses in Kenya (mean = 4.47, std deviation = 0.25) the current banks' lending rates have discouraged many SMEs owners to go for short term and long loans for their businesses (mean = 4.37std deviation = 0.18) high interest rates discourage many SMEs from approaching commercial banks for credit facilities (mean = 3.95std deviation =0.14) and that there is bias by banks when evaluating SMEs for bank loans as compared to large corporates as they are perceived to be riskier (mean = 3.94std deviation =0.04). The findings are in support of the research by Akerlof & Spence, (2013) that majority of the respondents were not satisfied with the lending terms because of high interest rates, short repayment period and long-time taken to process the credit facility. Majority of the respondents indicated that interest charged by the lending institution was significant in determining demand for credit by SMEs.

Table 4.8: Effect of Interest Rates on Credit Access from Commercial Banks

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std deviation
Interest rates charged by commercial banks are relatively high for and unsustainable for SME most businesses in Kenya	2.7%	3.4%	7.3%	52.3%	34.3%	4.47	0.25
High interest rates discourage many SMEs from approaching commercial banks for credit facilities	3.7%	6.1%	4.2%	57.6%	28.4%	3.95	0.14
The current banks' lending rates have discouraged many SMEs owners to go for short term and long loans for their businesses	1.9%	4.7%	1.5%	59.7%	32.2%	4.37	0.18
There is bias by Banks when evaluating SMEs for Bank loans as compared to large corporates as they are perceived to be riskier	3.6%	2.2%	8.1%	61.4%	24.7%	3.94	0.04

4.6 Interest Rate Capping

This section investigates the effect of interest rates capping on credit access from commercial banks

4.6.1 Effect of Interest Rates Capping On Credit Access from Commercial Banks

The research sought to establish the extent to which respondents agreed with the following statements relating to effect of interest rates capping on credit access from commercial banks. Results are analysed in Table 4.11. From the analysis, majority of respondents agreed that interest rate capping in Kenya has led to a high degree of exclusion from small loans for SMEs (mean = 4.22, std deviation = 0.18), interest rates capping has led to locking out of SMEs since they are considered as “high risk” borrowers (mean = 4.18, std deviation = 0.38), interest rate capping is harmful to our businesses (mean = 4.00 std deviation =0.15) and that after the interest rate capping bill signing, commercial banks have been asking sureties equal to the amount borrowed by SMEs (mean = 3.87std deviation =0.54) The findings are in support of the research by Lydia, (2012) revealed that interest rate capping in Germany and France led to a high degree of exclusion from small loans for SMEs in these countries and created a market for illegal lending.

Table 4.9: Effect of interest rates capping on credit access from Commercial Banks

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std deviation
Interest rate capping in Kenya has led to a high degree of exclusion from small loans for SMEs	3.2%	5.6%	8.6%	54.6%	28%	4.22	0.18
Interest rates capping has led to locking out of SMEs since they are considered as “high risk” borrowers	4.7%	4.1%	6.1%	55.4%	29.7%	4.18	0.38
After the interest rate capping bill signing, commercial banks have been asking sureties equal to the amount borrowed by SMEs	8.2%	6%	4.7%	61.3%	19.8%	3.87	0.54
Interest rate capping is harmful to our businesses	1.6%	3.2	3.3%	47.1%	44.8%	4.00	0.15

4.7 Correlation

On the correlation of the study variable, a Pearson moment correlation was conducted. From the finding in the table above, the study found that there was strong negative correlation coefficient between SMEs growth and development and collateral requirements, as shown by correlation factor of - 0.653, this relationship was found to be statistically significant as the significant value was 0.000 which is less than 0.05, the study found strong positive correlation between SMEs growth and development and knowledge on financial information as shown by correlation coefficient of 0.633, the significant value was 0.002 which is less than 0.05, the study found strong negative correlation between SMEs growth and development and high interest rates as shown by correlation coefficient of -0.602, this too was also found to be significant at 0.002, and finally the study found strong negative correlation between SMEs growth and development and interest rates capping as shown by correlation coefficient of -0.648 at 0.000 levels of confidence.

The findings concur with Curswoth, (2003) who found out that strong negative correlation between high interest rates and SMEs growth and development. The findings further agree with Ayodele (2011) who found out that strong positive correlation between knowledge on financial information and SMEs growth and development

Table 4.10: Correlations

		SMEs growth and development	Collateral Requirements	Knowledge On Financial Information	Interest Rates	Interest Rates Capping
SMEs growth and development	Correlation Coefficient	1.000	-.653	.633	-.602	-.648
	Sig. (1-tailed)	.	.476	.439	.335	.958
	N	225	225	225	225	225
Collateral Requirements	Correlation Coefficient	-.653	1.000	.142	.037	.001
	Sig. (1-tailed)	.000	.	.000	.003	.002
	N	225	225	225	225	225
Knowledge On Financial Information	Correlation Coefficient	.633	.142	1.000	.046	.008
	Sig. (1-tailed)	.002	.001	.	.000	.000
	N	225	225	225	225	225
Interest Rates	Correlation Coefficient	-.602	-.037	.046	1.000	.124
	Sig. (1-tailed)	.002	.000	.001	.	.002
	N	225	225	225	225	225
Interest Rates Capping	Correlation Coefficient	-.648	.001	.008	.124	1.000
	Sig. (1-tailed)	.000	.001	.003	.000	.
	N	225	225	225	225	225

4.8 Regression Analysis**4.8.1 Model Summary**

In this review, a numerous relapse investigation was directed to test the impact among indicator factors. The examination utilized (SPSS V 21.0) to code, enter and process the estimations of the numerous relapses. The model summary are presented in the table below

Table 4.11: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.818 ^a	.669	.652	.37290

The study used coefficient of determination to evaluate the model fit. The adjusted R², also called the coefficient of multiple determinations, is the percent of the variance in the

dependent explained uniquely or jointly by the independent variables. The model had an average adjusted coefficient of determination (R^2) of 0.652 and which implied that 65.2% of the variations in SMEs growth and development are explained by the independent variables understudy (collateral requirements, Knowledge on financial interest rates and interest rates capping).

4.8.2 ANOVA

The study further tested the significance of the model by use of Analysis of Variance (ANOVA) technique. The findings are tabulated in table below. From the ANOVA statics, the review set up the relapse demonstrate had a significance level of 0.1% which means that the information was perfect for making a conclusion on the populace parameters as the estimation of noteworthiness (p-value) was under 5%. The calculated value was greater than the critical value ($4.083 > 2.50$) an indication that collateral requirements, Knowledge on financial interest rates and interest rates capping have a significant effect on SMEs growth and development. The significance value was less than 0.05 indicating that the model was significant.

Table 4.12: Summary of One-Way ANOVA results

Model	Sum of Squares	Df	Mean Square	F	Sig.	
1	Regression	0.392	4	0.098	4.083	.001 ^b
	Residual	5.28	220	0.024		
	Total	5.672	224			

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	-.176	.317		-0.555	0.592
Collateral Requirements	-.417	.096	-.397	-4.344	.000
Knowledge on Financial Information	.596	.143	.670	4.168	.001
Interest Rates	-.569	.118	-.394	-4.822	.000
Interest Rates Capping					
	-.492	.122	-.413	-4.033	.003

Critical value =2.50

4.8.3 Coefficients of Determination

In addition, the study used the coefficient table to determine the study model. The findings are presented in the table below.

Table 4.13: Coefficients

As per the SPSS generated output as presented in table above, the equation ($Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$) becomes:

$$Y = -0.176 + (-0.417X_1) + 0.596X_2 + (-0.569X_3) + (-0.492X_4)$$

From the regression model obtained above, a unit increase in collateral requirements would lead to a decrease in growth of SMEs by a factor of -0.417; a unit change in Knowledge on financial information growth of SMEs will promote growth of SMEs by a factor of 0.596, a unit increase on lending interest rates would lead to a decrease in growth of SMEs by a factor of -0.569 and a unit change in interest rates capping would lead to a decrease in growth of SMEs by a factor of -0.492 and vice versa. The findings above conform to findings by March (2011), that lending interest rates are directly related to SMEs growth and development. The analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the obtained probability value and $\alpha=0.05$. If the probability value was less than α , then the predictor variable was significant otherwise it wasn't. All the predictor variables were significant in the model as their probability values were less than $\alpha=0.05$.

4.9 Chapter Summary

With the use of a questionnaire in data collection, data from 225 respondents was gathered and used in the analysis. Quantitative data collected was analyzed with the use of descriptive statistics using Strategic package for social sciences (SPSS) and presented through percentages, means, standard deviations, frequencies and Karl Person's coefficient of correlation. A response rate of 93.3% was sufficient to draw conclusions for the study. Genders of the respondents as shown by 57.3% were males whereas 42.7% were females this implies that all genders were considered in the study and the participants had sufficient education and thus could understand and respond to research questions easily. Majority of the respondents have been in business for a period of 8-10 years thus they had sufficient knowledge and understanding to respond to the questions.

The research findings showed that a unit increase in collateral requirements would lead to a decrease in growth of SMEs by a factor of - 0.417, the study found that there was strong negative correlation between SMEs growth and development and collateral requirements, (correlation value = 0.653). Results obtained on effect of financial information on credit access from commercial banks showed that a unit change in Knowledge on financial information growth of SMEs promoted growth of SMEs by a factor of 0.596.

Furthermore the study found out a strong positive correlation between SMEs growth and development and knowledge on financial information (correlation coefficient = 0.633). In addition a strong negative correlation between SMEs growth and development and high interest rates (correlation coefficient = - 0.602,) Regression analysis results indicated an inverse relationship between the level of interest rates and the amount of credit granted by commercial banks. Moreover it was established that interest rate capping in Kenya has led to a high degree of exclusion from small loans for SMEs, a unit change in interest rates capping would lead to a decrease in growth of SMEs by a factor of - 0.492 and vice versa. Finally the study found a strong negative correlation between SMEs growth and development and interest rates capping (correlation coefficient = -0.648).

CHAPTER FIVE

5.0 DISCUSSIONS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the discussion of key findings, conclusion drawn from the findings highlighted and recommendation made there-to, the conclusions and recommendations drawn were focused on addressing the objective of the study the researcher had intended to analyse credit access from commercial banks and growth of small and micro enterprises operating in Nairobi Central Business District.

5.2. Summary

Lack of access to credit is a major constraint inhibiting the growth of the SMEs sector. The issues and problems limiting SMEs access to financial services include lack of tangible security coupled with inappropriate legal and regulatory framework that does not recognize innovative strategies for lending to SMEs. Limited access to formal finance due to poor and insufficient capacity to deliver financial services to SMEs continues to be a constraint in the growth and expansion of the sector. Formal financial institutions perceive SMEs as high risk and commercially not viable and as a result only a few SMEs access credit from formal financial institutions. The study sought to analyse credit access from commercial banks and growth of small and micro enterprises operating in Nairobi Central Business District , With the adoption of a questionnaire data collection tool, the data from 225 respondents were used in the analysis Quantitative data collected was analyzed by the use of descriptive statistics using. Strategic package for social sciences (SPSS) and presented through percentages, means, standard deviations, frequencies and Karl Person's coefficient of correlation

From the regression model obtained , a unit increase in collateral requirements would lead to a decrease in growth of SMEs by a factor of -0.417; a unit change in knowledge on financial information growth of SMEs will promote growth of SMEs by a factor of 0.596, a unit increase on lending interest rates would lead to a decrease in growth of SMEs by a factor of - 0.569 and a unit change in interest rates capping would lead to a decrease in growth of SMEs by a factor of - 0.492 and vice versa, this is summarised below $Y = -0.176 + (-0.417X_1) + 0.596X_2 + (-0.569X_3) + (-0.492X_4)$.

The research established that a unit increase in collateral requirements would lead to a decrease in growth of SMEs by a factor of - 0.417, the study found that there was strong

negative correlation between SMEs growth and development and collateral requirements, (correlation value = 0.653) descriptive results also noted that loaned SMEs were highly dissatisfied with the collateral requirements by the bank; banks required the SMEs to have an operational bank account with them before lending loans to them lack of basic collateral requirements by commercial banks limited the SMEs from credit access thus affecting their projects negatively. Collateral requirements by commercial banks affected the borrowing capability by the SMEs and the general performance of the SMEs owned projects. According to Ang et al., (1995), access to loans and credit facilities has been and is still a major problem for a large portion of SMEs.

Results obtained on effect of financial information on credit access from commercial banks showed that a unit change in Knowledge on financial information growth of SMEs promoted growth of SMEs by a factor of 0.596. The study also found a strong positive correlation between SMEs growth and development and knowledge on financial information (correlation coefficient = 0.633). Descriptive results also showed that the SMEs in Kenya can rarely meet the conditions set by financial institutions which include provision of financial information regarding their businesses. Most of SMEs fear going for credit from commercial banks based on the many hidden charges, most SMEs owners lack adequate financial information and literacy to evaluate the cost of credit and the various financial products offered by banks. The findings are in support of the research by Kashyap, Stein & Wilcox (2013). The lack of quality information was the biggest SME-specific hindrance and obstacle to SME lending.

The study found a strong negative correlation between SMEs growth and development and high interest rates (correlation coefficient = - 0.602,) Regression analysis results indicated an inverse relationship between the level of interest rates and the amount of credit granted by commercial banks. When interest rates increase, the amount of credit granted by commercial banks to their customers decreases while when interest rates decline, the amount of credit granted by commercial banks increases Descriptive results also show that the current banks' lending rates have discouraged many SMEs owners to go for short term and long loans for their businesses.

High interest rates discourage many SMEs from approaching commercial banks for credit facilities and that there is bias by banks when evaluating SMEs for bank loans as compared to large corporates as they are perceived to be riskier. The findings are in support of the research by Akerlof & Spence, (2013) that majority of the respondents

were not satisfied with the lending terms because of high interest rates, short repayment period and long-time taken to process the credit facility.

The research established that interest rate capping in Kenya has led to a high degree of exclusion from small loans for SMEs, a unit change in interest rates capping would lead to a decrease in growth of SMEs by a factor of - 0.492 and vice versa. The study also found a strong negative correlation between SMEs growth and development and interest rates capping (correlation coefficient = -0.648). Descriptive results showed that interest rates capping has led to locking out of SMEs since they are considered as “high risk” borrowers. Interest rate capping is harmful to businesses that after the interest rate capping bill signing, commercial banks have been asking sureties equal to the amount borrowed by SMEs. The findings are in support of the research by Lydia, (2012) revealed that interest rate capping in Germany and France led to a high degree of exclusion from small loans for SMEs in these countries and created a market for illegal lending.

5.3 Discussions

5.3.1 Effect of Collateral Requirements on Credit Access from Commercial Banks

The first objective of the research was to establish the effect of collateral requirements on credit access from commercial banks. Results obtained showed that a unit increase in collateral requirements would lead to a decrease in growth of SMEs by a factor of - 0.417. Further the study noted that costs associated with the collateralization process like legal fees, stamp duty, valuation, insurance etc discourage borrowing by SMEs from commercial banks, Stringent credit terms imposed by Banks discourage potential borrowers from approaching banks for financing.

Collateral requirements serve as an incentive mechanism because higher collateral enforces a selection of less risky projects. This is due to the fact that a lower-risk borrower has a greater incentive to pledge collateral than a high-risk borrower, because of his lower probability of failure and loss of collateral. The willingness of the entrepreneur to pledge collateral positively influences the quality of credit request as perceived by the bank. Borrowers signal the real value and belief in the quality of the project to the bank. Thus, low risk borrowers can signal their status through the provision of collateral, even though literature identifies collateral as a key, contracting tool employed by lenders to reduce the problem associated with asymmetrical information.

According to Stiglitz and Weiss (1981) collateral acts as an indicator of the borrower's creditworthiness. The bank screens firms by offering both loan contracts with higher collateral value with lower interest rates and loan contracts with lower collateral with higher interest rates. Although risk factors may not be readily observable, lower risk borrowers will nonetheless pledge more and better collateral value than riskier borrowers because this pledge is less costly for borrowers who have lower likelihoods of losing the pledged collateral. The probability of losing collateral acts as a disciplinary tool for the borrower. Thus, the pledge of collateral leads to a higher level of effort to satisfy loan conditions and meeting loans obligations, reducing a borrower's default probability. Collateral therefore serves as a tool for resolving moral hazard problems.

Inability of SMEs to pledge tangible security inhibits their access to credit facilities offered by banks lack of fixed assets is a hindrance to many SMEs access to credit from commercial banks, duration taken to register and create a charge on the security pledged to a bank discourages SMEs from borrowing from commercial banks and that inability of SMEs to access loans from banks is one created by the financial institutions mainly through their lending policies. The findings are in support of the research by Rahman, Davanzo & Sutradhar, (2006) that The Collateral requirements for SME loans are higher than for consumer loans, because SMEs' credit risk is usually more difficult to evaluate and that SMEs tend be more vulnerable to economic and political shocks relative to corporate clients, and this would justify an extra layer of security from an SME borrower.

The study also revealed that SMEs ability to easily access finance to expand business is restricted by collateral requirements and unexplained bank charges. This means that a majority of SMEs are not able to access finance to enable them grow. Collateral, interest rates, extra bank charges, inability to evaluate financial proposals and lack of financial management skills also hinder the growth of SMEs (Stiglitz & Weiss, 1981). Informal sources of credit though with high interest rates, constitute very substantial contributions to business start-ups in developing countries (Mwangi et al, 2013).

The study further noted that loaned SMEs were highly dissatisfied with the collateral requirements by the bank; banks required the SMEs to have an operational bank account with them before lending loans to the them, lack of basic collateral requirements by commercial banks limited the SMEs from credit access thus affecting their projects negatively, collateral requirements by commercial banks affected the borrowing capability by the SMEs and the general performance of the SMEs owned projects.

According to Ang et al., (1995), access to loans and credit facilities has been and is still a major problem for a large portion of SMEs. Moreso Gangata and Matavire, (2013) in their study on challenges facing SMEs in accessing finance from financial institutions, found out that very few SMEs succeed in accessing funding from financial institutions, the main reason being failure to meet lending requirements, chief among them being provision of collateral security. A study was done on challenges faced by Small & Medium Enterprises (SMEs) in obtaining credit in Ghana. Based on the responses received through the questionnaires circulated, it became evident that SMEs in Ghana like most SMEs in other countries are faced with major challenges in accessing credit. These challenges were revealed by the study to include, the inability of SMEs to provide collateral and other information needed by banks such as audited financial statement coupled with the high cost of loan in terms of high interest rates making it extremely difficult to access bank loans (Vuvor & Ackah, 2011).

5.3.2 Inadequate Financial Information

The access to credit information in local lending environments determines the extent to which small enterprises obtain sufficient external financing to exploit profitable projects. Access to information is important both from the SMEs perspective and from the perspective of the providers of financial services and products. The SMEs require information with which to identify the potential suppliers of the financial products. It requires this information to evaluate the cost of the financial services and products that are being offered. The financial services providers require information with which to evaluate the risk profile of the SMEs applying for finance, and to assess the prospects of the SMEs within the market segment. One of the problems faced by SME when attempting to raise finance is information asymmetry in that they cannot prove the quality of their investment projects to the provider of finance. SMEs managers often lack financial sophistication, as they are often product or service specialist, not specialists in the area of finance.

Results obtained on effect of financial information on credit access from commercial banks showed that a unit change in Knowledge on financial information growth of SMEs will promote growth of SMEs by a factor of 0.596, the findings also revealed that SMEs in Kenya can rarely meet the conditions set by financial institutions which include provision of financial information regarding their businesses, most of SMEs fear going for credit from commercial banks based on the many hidden charges, most SMEs owners

lack adequate financial information and literacy to evaluate the cost of credit and the various financial products offered by banks, inadequate information from banks in the form of prescribed minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes discourages SMEs owners from approaching commercial banks for loans, and that SMEs require information with which to identify the potential suppliers of the financial products, the study also revealed that granting of loans or credit to SMEs is still a major problem as many of SMEs are unable to access such funds. Also, there is the problem of inadequate information between the loan provider and loan receiver as to the availability and cost.

The study revealed that most SMEs borrowers borrowed only a small amount of money from the financial institutions since they were only eligible to access such amounts given the criteria set by the institutions and also because they were reluctant to take out large amounts that they may not be able to repay. Such small amounts can only have so little impact on SMEs financial performance. The findings are in support of the research by Kashyap, Stein & Wilcox, (2013) that the lack of quality information was the biggest SME-specific hindrance and obstacle to SME lending.

Banks offered no formal financial training to some of the SME members or representatives of SME groups. The findings are in support of the literature by Hogarth, (2002) that many of SMEs owners have very little understanding of finances, how credit works and the potential impact on their financial well-being for many. The findings are in support of the research by Lusard and Mitchell, (2007) that the lack of financial understanding has been signalled as one of the main reasons behind savings and investing problems faced by many SME in Kenya.

The study also noted that financial training support promoted SME investment culture and simplify the decision-making process, including helping members to implement their investment plans. The findings are in support of the literature by Beal and Delpachitra, (2003) that knowledgeable about finance prepared SME members to take on challenges that come their way, enables group leaders to manage project finances efficiently, prepare for taxes and possible audits, balance their books, predict profits and plan their future accordingly and also created spheres of financial literacy.

Educated entrepreneurs have the ability to present positive financial information and strong business plans notwithstanding the fact that they have the ability to maintain a

better relationship with financial institutions compared to less educated entrepreneurs. While educated managers/owners have the skills to manage the other functions of the business such as finance, marketing, human resources and these skills results to high performance of the business which helps those firms to access finance without any difficulty. Banking institutions value higher education level of the owner/manager in the loan approval process as an important criterion. Previous researchers have found positive relationships between previous management experience and business growth, and therefore better placed in accessing finance.

5.3.3 Effect of Interest Rates on Credit Access from Commercial Banks

In many developing countries, the overall interest rates are relatively high to begin with, such that rates charged by micro lending schemes are quite high when the risk premium is added. Most of these micro-institutions claim a high rate of repayment. This is attributable to the informal participatory structures, which create an atmosphere in which debtors respect their obligations. While this phenomenon is certainly true of the better-run institutions, it is not possible to verify whether this is a universal feature. While the high rates remain, commercial lending by banks has shrunk in favour of bank holdings of government securities. The popularity of exorbitantly high real lending rates and the continuing increase in the lending deposit rate margins is particularly worrying. Interest rates have remained high in most countries despite the reforms intended to make the markets them more efficient. Thus, interest rates act as a mechanism to avoid high risk borrowers. Interest rates are determined by the maximum expected return to banks rather than being established by supply and demand forces. However, as soon as banks adopt very risk-averse behaviour they may decide to set the charged interest rate below that one maximizing the expected return, since further increases in the interest rate could increase their probability of going bankrupt.

In this study results show that Interest rates have an effect on credit granted by commercial banks in Kenya. Regression analysis results indicate an inverse relationship between the level of interest rates and the amount of credit granted by commercial banks. When interest rates increase, the amount of credit granted by commercial banks to their customers decreases while when interest rates decline, the amount of credit granted by commercial banks increases.

The study revealed that unit increase on lending interest rates would lead to a decrease in growth of SMEs by a factor of - 0.569, interest rates charged by commercial banks are relatively high for and unsustainable for SMEs most businesses in Kenya, the current banks' lending rates have discouraged many SMEs owners to go for short term and long loans for their businesses, high interest rates discourage many SMEs from approaching commercial banks for credit facilities and that there is bias by banks when evaluating SMEs for bank loans as compared to large corporates as they are perceived to be riskier.

The findings are in support of the research by Akerlof & Spence, (2013) that majority of the respondents were not satisfied with the lending terms because of high interest rates, short repayment period and long-time taken to process the credit facility. Majority of the respondents indicated that interest charged by the lending institution was significant in determining demand for credit by SMEs. This study clearly shows that there is close relationship between interest rates and loan repayment in conjunction with business growth and performance. High interest rates, coupled with lack of entrepreneurial skills were seen as the major factors that have a direct bearing with the loan repayment among entrepreneurs. The study noted that in as much loans have great role in business growth and development and therefore performance, the level of interest rates has a significant effect in premium repayment (Mommel, Schneider & Stein, 2007).

Further the research revealed that considerable numbers of SME owners in Nairobi were uncomfortable with the current interest rate level. The findings are in line with the research by Thordsen and Nathan (1999) that when interest rates are low, SME owners in Nairobi are willing to borrow because they find it relatively easy to repay their debt. When interest rates are high, SMEs owners are reluctant to borrow because repayments on loans cost more, some SME owners in Nairobi even find it difficult to meet their existing loan repayments, especially if interest rates increase faster than the rise in a consumer's income. If interest rates rise sharply and stay high for a long period, some consumers will default on their loans.

Many policy makers question why microfinance interest rates remain high even when MFIs receive concessional funds to finance lending. Although micro lenders receive loan funds at concessional rates, they must cost these funds at market rates when they make decisions about interest rates to ensure the sustainability of the institution's operations. Donors provide concessional funds for a particular usage only for a limited period, as do some governments. However, concessional funds cannot be considered a permanent

source of funds for MFIs, and provision must be made through interest rates to sustain the lenders' operations. Inflation adds to the cost of microfinance funds by eroding micro lenders' equity. Thus, higher inflation rates contribute to higher nominal credit interest rates through their effect on the real value of equity (Fernando N, 2006).

5.3.4 Effect of Interest Rates Capping On Credit Access from Commercial Banks

Regulation of the inflation or deflation in Kenya is a role assigned to the CBK by the government. The need to regulate the interest charged on credit or any other financial tool is founded on the necessity to control economic patterns that has great effects to the economy. Controlling and setting of interest rates has huge fiscal implication to the economic development hence the need for rational decision making process within the industry. Many countries have established interest rate ceilings to protect consumers from unscrupulous lenders. Governments often also face political or cultural pressure to keep interest rates low.

This research established that interest rate capping in Kenya lead to a high degree of exclusion from small loans for SMEs, since a unit change in interest capping will lead to a decrease in growth of SMEs by a factor of - 0.492 and vice versa. Interest rates capping has led to locking out of SMEs since they are considered as “high risk” borrowers, interest rate capping is harmful to our businesses and that after the interest rate capping bill signing, commercial banks have been asking sureties equal to the amount borrowed by SMEs, The findings are in support of the research by Lydia, (2012) which revealed that interest rate capping in Germany and France led to a high degree of exclusion from small loans for SMEs in these countries and created a market for illegal lending. Weak decisions on the interest rates will directly impact the economic performance in all industries but significantly on the financial sectors. Interest rate control is a monetary instrument used in Kenya, when CBK rises its lending rate to financial institution it gesture the same to financial institution, consequently the financial institution do the same.

Results also show that low interest rates lead to excess demand for credit, inevitably leading to credit rationing. Interest rate caps undermine the average quality of investment, yielding financial repression. The findings are consisted with those by McKinnon (1973) and Shaw (1973) who propounded that interest rate caps reduce returns on saving which ultimately reduce both the quality and quantity of investment. Results also show that caps

on interest rates prompt financial institutions to avoid lending to high-risk borrowers such as SMEs. This in effect reversed the main aim of helping start up investors have access to credit. Caps on interest rates also open the door for informal lending avenues which in most cases exploit upcoming SME investors. This is likely to affect entrepreneurs, who would wish to get into business, as they are considered high-risk borrowers due to their limited sources of income.

In some cases, banks and financial institutions withdrew from low-income areas and this further curtailed access to credit facilities, the main argument being that if interest rates became too low it will make operations in low-income areas unsustainable. Banks and other financial institutions also avoid investing in areas considered unprofitable. Results also show that caps on interest rates may lead to a decline in the number of credit products available to consumers. This limits access to credit and innovation. Although it is still early to tell how the cap on bank interest rates will affect the Kenyan SME owners, empirical evidence as indicated shows that in most cases, the outcomes are negative. This may or may not be the case for Kenya. Furthermore other studies have argued contrary to the use of interest rate ceiling since it's an unproductive instrument for reducing interest rates, in the long-run. They also reduce the access to credits, limit transparency, and reduce product competition and diversity. Furthermore they reduce the demand for loans and impacts negatively the firms' output. Moreover, due to interest rate caps the market is distorted and create adverse selection, financial firms have a tendency to lend to customers with higher security, thus creating inefficiencies in financial intermediation. As a result, financial institutions Limiting their lending to those who are in need of it most but limited access to alternative sources of credit (Miller 2013).

5.4 Conclusions

5.4.1 Effect of Collateral Requirement on Credit Access

Collateral requirement has been one of the major hindrances for SMEs access to credit from commercial banks. Majority of the SMEs owners do not have sufficient collateral which is a major requirement for credit access. SMEs encounter problems of raising capital, accessing finance and accessing credit. Majority of the businesses obtain start-up capital from self-financing.

5.4.2 Effect of Financial Information Knowledge on Credit Access

Most SME owners lack adequate financial information and literacy to evaluate the cost of credit and the various financial products offered by Banks, most SMEs borrowers borrowed only a small amount of money from the financial institutions since they were only eligible to access such amounts given the criteria set by the institutions and also because they were reluctant to take out large amounts that they may not be able to repay. The lack of quality information was the biggest SME-specific hindrance and obstacle to SME lending.

5.4.3 Effect of Banks' Lending Rates on Credit Access

The current banks' lending rates have discouraged many SMEs owners to go for short term and long loans for their businesses, SMEs owners were not satisfied with the lending terms because of high interest rates, short repayment period and long-time taken to process the credit facility. High interest rates, coupled with lack of entrepreneurial skills were seen as the major factors that have a direct bearing with the loan repayment among entrepreneurs.

5.4.4 Effect of Interest Rates Capping On Credit Access

Interest rate capping in Kenya has led to a high degree of exclusion from small loans for SMEs and that Interest rate capping is harmful to SMEs, interest rate caps reduce returns on saving which ultimately reduce both the quality and quantity of investment and that Caps on interest rates also open the door for informal lending avenues which in most cases exploit upcoming SME investors. This is likely to affect entrepreneurs, who would wish to get into business, as they are considered high-risk borrowers due to their limited sources of income.

5.5 Recommendations

5.5.1 Recommendations for improvement

Lack of access to credit is a major constraint inhibiting the growth of SMEs sector. From the summary and conclusion, the study recommends the government to set up policies that will ease microfinance credit to SME's. These policies should be in line with both the owners of SME's and financial institutions in order to prevent putting hindrances to potential and credit worthy customers who seek to expand or start up a business. This will create a window for growth and development of the economy as a result of more job opportunities and increased flow of money circulation in the economy.

5.5.1.1 Collateral requirements

Financial institutions should consider reassessing on collateral requirements. This should be done with a view of making credit provision more affordable to less advantaged individuals. There is need to provide an enabling environment for SME s to grow and thrive, therefore there is a need to develop strategies to enhance increased access to microfinance credit by SME's from commercial banks and microfinance institutions.

5.5.1.2 Financial Information Knowledge

Financial institutions should also provide financial advisory services to individual proprietors when advancing credit to them; lower lending rates while improving service Delivery and train people on risk management and financial management. The Government should also regulate financial institutions to ensure that the owners and managers of SME's get access to information in order to make the right investment decisions. Financial institutions should ensure that they sensitize the owners of SMEs on best financial management practices. This will help the owners of SME's to account for loans. Borrowed. Lending institutions should also advise borrowers on how to appraise their projects for viability to ensure that they make wise decisions when investing in projects.

5.5.1.3 Interest rates

The government should also come to the aid of SMEs by regulating how financial institutions raise and lower their interest rates. This will not only help the government to improve on its economic activities as a result of easy access to credit by SMEs but will also improve on the livelihood of most individuals who are owners and employees of the SMEs enterprises based in the city.

5.5.1.4 Interest Rates Capping

Central bank should set policies and procedures to prevent barriers that inhibit potential owners and managers of SME's from accessing credit facilities. This will create conducive environment for SME's to growth and expand. It will also open up opportunities for jobs and this will enhance economic growth.

5.5.2 Recommendations for Further Studies

Based on the findings in the present study, there are areas which require further research. A study need to be carried out on sustainability of economic growth of the SMEs

financed by commercial banks loans. How lasting is the growth that they have experienced? Growth comes with a number of challenges and hence a study needs to be done on the environmental impact of commercial banks fund on SMEs they finance. Further study can be done on SMEs licensed to operate in other counties to confirm the consistency of the results. The study proposes for a similar research this time assessing the effect of market risks on performance of SMEs.

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APPENDICES

Appendix I: Introduction Letter

Edward Etemesi

P.O. Box

Nairobi

Dear Respondent,

Re: Data collection for research study

I am a student at United States International University. I am conducting an investigation on credit access from commercial banks and growth of small and micro enterprises operating in Nairobi Central Business District. Please answer the following questions honestly and objectively to the best of your knowledge, the information obtained will be treated with strict confidentiality. Please do not write your name on the questionnaire.

Thank you for your acceptance and support.

Yours faithfully

Edward Etemesi

Appendix II: Questionnaire

The purpose of this Questionnaire is to seek answers to that will assist analyse Credit access from Commercial Banks and growth of Small and Micro Enterprises operating in Nairobi Central Business District: Confidentiality on the information which the respondents will provide is guaranteed, and will be used for academic purposes only.

Part A: Demographic Information

1. Gender Male Female
2. Indicate by ticking your age bracket
 - i. 20- 25 years of age
 - ii. 26-30 years
 - iii. 31 -35 years
 - iv. 36 -40 years
 - v. Above 40 years
- 3 What is your highest level of Education? (Tick as applicable)
 - a) Diploma
 - b) Degree
 - c) Post graduate
 - d) Others (specify)_____
- 4 . Period Indicate the in years you have been working in your SME.
 - a) Less than one year
 - b) 1-3 years
 - c) 3-7 years
 - d) 8-10 years
 - e) Above 10 years
5. What is the annual turnover of your SME (Amount in kshs).
 - a) Below 50,000
 - b) 50,000-100,000
 - c) 100,000-200,000
 - d) Over 200,000

SECTION B: MAIN ISSUES

COLLATERAL REQUIREMENTS

6. Indicate, by ticking appropriately, the effects of collateral requirements in accessing credit from commercial banks where is (1-strongly agree, 2-agree, 3-Neutral, 4- Disagree, 5-strongly disagree).

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Inability of SMEs to pledge tangible security inhibits their access to credit facilities offered by Banks					
Lack of fixed assets is a hindrance to many SMEs access to credit from Commercial Banks					
Costs associated with the collateralization process like legal fees, stamp duty, valuation, insurance etc discourage borrowing by SMEs from Commercial Banks					
Duration taken to register and create a charge on the security pledged to a Bank discourages SMEs from borrowing from Commercial Banks.					
Stringent credit terms imposed by Banks discourage potential borrowers from approaching Banks for financing					
Inability of SMEs to access loans from Banks is one created by the financial institutions mainly through their lending policies					

INADEQUATE FINANCIAL INFORMATION

7. Please tick appropriately whether you strongly agree, Agree, not sure/Neutral, Disagree, and Strongly Disagree with each of these statements.

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Most of SMEs fear going for credit from commercial banks based on the many hidden charges					
Inadequate information from Banks in the form of prescribed minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes discourages SME owners from approaching Commercial Banks for loans					
SMEs in Africa can rarely meet the conditions set by financial institutions which include provision of financial information regarding their businesses					
SMEs require information with which to identify the potential suppliers of the financial products.					
Most SME owners lack adequate financial information and literacy to evaluate the cost of credit and the various financial products offered by Banks					

INTEREST RATES

8. To what extent do you agree with the following statements that relate to effect of interest rates on credit access from commercial banks?

Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Interest rates charged by commercial banks are relatively high for and unsustainable for SME most businesses in Kenya					
High interest rates discourage many SMEs from approaching commercial banks for credit facilities					
The current banks' lending rates have discouraged many SMEs owners to go for short term and long loans for their businesses					
There is bias by Banks when evaluating SMEs for Bank loans as compared to large corporates as they are perceived to be riskier					

INTEREST RATE CAPPING

9. To what extent do you agree with the following statements that relate to effect of interest rates capping on credit access from commercial banks?

statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Interest rate capping in Kenya has led to a high degree of exclusion from small loans for SMEs					
Interest rates capping has led to locking out of SMEs since they are considered as “high risk” borrowers					
After the interest rate capping bill signing, commercial banks have been asking sureties equal to the amount borrowed by SMEs					
Interest rate capping is harmful to our businesses					