

## Factors Affecting Access to Credit By Small and Medium Enterprises: A Case of Kitale Town

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**ABSTRACT:** *The study sought to establish the factors influencing access to credit among small and medium scale enterprises in Kitale Municipality. The study was guided by the following objectives: to find out how lending procedures affect access to credit by small and medium scale enterprises; to find out how collateral requirements influence access to credit by SMEs; to establish the relationship between the credit bureau referencing policies and access to credit by SMEs; and to find out the influence of education and entrepreneur training and access to credit by SMEs. A descriptive survey design method was used to collect data. The target population was made up of the 726 SME's registered with Kitale Municipal Council. Stratified random sampling technique was used to determine the sample size. Using the Krejcie and Morgan formula a sample size of 256 SME's was considered for the study. Data was collected by the use of questionnaires and interviews. Piloting of the study was carried out in the to ascertain the validity and reliability of the instruments. Data analysis included the use of descriptive and inferential statistics. Descriptive statistics involved the use of frequency tables, pie charts, graphs and percentages while inferential statistics involved the use of correlation analysis. The study established that among the factors that lending procedures, collateral requirement, credit bureau referencing policies and training offered by finance Institutions significantly influence access to credit facility by SME from financial institutions. The key recommendation was that information symmetry should be enhanced between CRBs and financial institutions on one hand and SMEs on the other hand.*

**Key words:** Credit Reference Bureau, Credit, Small and Medium Enterprises

### 1. INTRODUCTION

Small and medium enterprises are of vital importance to the economic development. According to the SME Statistics Division of National Development and Reform Commission in 2007, small and medium enterprises in China have created about 60% of GDP, 68% of exports, 66% of the intervention patent, 82% of the new products development more importantly it eases large number of Chinese labour employment. Small and medium enterprises in expansion need

external financing for getting a lot of money. Small, medium and large have different business conditions of transparency and mortgage and lending unit cost decreases with increase in the size of the loans and other reasons. Financial institutions are generally more willing to provide financial services for the large enterprises and not SMEs. Supply of financial institutions in lending to medium enterprises is far below their demand for credit. Financing has become an important

factor in impeding the development of small and medium enterprises the development of small and medium enterprises.

Credit Reference Bureaus (CRB) are information brokers. They may be set up by lenders and operated by them or they may be for-profit institutions that provide detailed data. In some cases, mostly in continental Europe and in Latin America, the central bank or another regulatory agency creates a compulsory mechanism of public credit registrars or risk centrals that usually provide aggregated data on major business borrowers (Guillermo Bolaños, 2000).

In all economies, developing and developed ones, easy access to credit is a very important factor in accelerating investments, job creation, transforming small businesses into strong enterprises. For example, despite the United Kingdom having one of the best banking and financial systems in the world, successive governments have made this possible by working closely with lenders and consumer advisers. This has resulted in a system that gives consumers access to credit at any time of day or night, every day of the year. Consumers can apply for credit over the phone or on the internet and get a decision almost instantly (Merton & Poll, 2008).

Traditionally, in many African countries, access to credit was mainly the reserve of corporate bodies, leaving out individuals and small enterprises even though they constitute a huge mass of consumers and whose micro-investments can have a great bearing on the whole economy. Thus, in African, CB's were introduced in countries like Egypt, Nigeria and Libya to enable individuals and small enterprises to get credit facilities in banks.

In Kenya too, access to credit has in the past been complicated due to stringent conditions imposed by commercial banks. In order to make banks more confident, and reward 'good' borrowers, the Credit Information Sharing mechanism was launched in Kenya following the gazetting of the

Banking (Credit Bureau) Regulations 2008 on 11th July 2010. The Regulations were issued pursuant to an amendment to the Banking Act passed in 2006 that made it mandatory for the Deposit Protection Fund and institutions licensed under the Banking Act to share information on Non-Performing Loans through credit reference bureaus licensed by the Central Bank of Kenya. In addition, the amendment to the law also provides for sharing of information on Performing Loans (FSD Kenya, 2008).

A key concern that was expressed about lending in Kenya prior to the introduction of the CB's was the ability for borrowers to take out loans at multiple institutions, sometimes even at the same institution across different branches, and declare different information about themselves allowing them to get credit easily, without fear of being declined and this had made Credit Risk Management (CRM) difficult. With the introduction and institution of the credit bureau at Diamond Trust Bank, they have been able to reduce these exposures. The credit bureau is assisting to highlight risks where other exposures are and how they are being managed by the borrowers concerned. They can also see how well or not these debts are being repaid and can use this information to make further quality decisions (Njuguna Ndung'u, 2009).

Credit is provided in the context of information asymmetry on both sides (Fischer, 1995) and can be resolved by demonstrating creditworthiness and project viability. However, because of poor accounting practices and record keeping, many SMEs are unable to do so (Cook & Nixson, 2000; Binks, Ennew, and Reed, 1992). This increases the risks and transaction costs (for monitoring and screening) of SME lending. Banks require collateral to manage this risk. These issues exacerbate other managerial problems of SMEs. For example, they determine not just the level but also the nature of technology investment (Cobham, 1999). Even with sound management

and strong product demand, the lack of credit constrains their capacity to respond to the market and expand production (Cook and Nixon, 2000).

## 1.2 Statement of the problem

SMEs are vital for economic growth and development in every country including African countries. Studies indicate that in both advanced economies and developing countries SMEs contribute 60 percent of total formal employment in the manufacturing sector (Ayyagari et. Al, 2007). These is because they encourage entrepreneurship, generate employment, and reduce poverty (Kayanula and Quartey 2000; Mead and Liedholm 1998; Fischer 1995) however they are not able to work to their optimal level due to the challenge they face which is lack of adequate finance and limited access to credit. In Kenya many SMEs do not have access to finance and credit especially from financial institutions such as commercial banks. This is because of the lending conditions given to them such as collateral to the loan. These enterprises may not be able to provide collateral for the loan such as immovable assets due to the small asset base. (Viona and Fredrick Mutua, 2012). SMEs in Kitale municipal have been faced by a limitation of credit facilities. It is important that banks provide credit facilities in order for them to grow. Banks have to take credit risks with the SME's despite credit risks being one of the major causes of bank failures. This is majorly due to among others, the incomplete credit information regarding borrowers. Credit reference bureau gathers information about how borrowers use credit. This information is then used by credit providers to decide whether or not to grant credit to borrowers. These minimize their credit provision risk and have confidence when extending credit (Kohn 2003). The CBK introduced CRB's to solve the problem of information asymmetry that had existed between lenders and borrowers. But, despite the importance of CRB's in solving the problem of CRM, no study known to the

researcher has been conducted to determine the effect of CRB's on access to credit by small and medium enterprises. This study therefore attempted to address this knowledge gap by providing research-based evidence on the effect of CRB's practices and policies on SMEs on access to credit in Kitale Municipality.

## 1.3 Research Objectives

### 1.3.1 General Objective

The general objective of the study was to assess factors influencing access to credit from financial institutions by SMEs in Kitale Municipality, Kenya.

### 1.3.2 The specific objectives

The specific objectives of the study included the following.

- i) To establish how lending procedures affect access to credit by small and medium scale enterprises in Kitale Town
- ii) To determine how collateral requirements influence access to credit by small and medium scale enterprises in Kitale Town
- iii) To establish the relationship between the credit bureau referencing policies and access to credit by SMEs in Kitale town
- iv) To determine the influence of education and entrepreneur training on access to credit by SMEs in Kitale town

## 1.4 Research Questions

The following research questions guided the study:

- i) Do the lending procedures adopted by financing institutions affect access to credit by small and medium scale enterprises in Kitale Town?
- ii) Is there any influence of collateral requirements on small and medium scale enterprises ability to access credit facilities in Kitale?

iii) Is there a relationship between Credit Bureau Reference Policies and access to credit within Kitale town?

iv) Is there a relationship between entrepreneur skills and training and access to credit in Kitale town?

## 2.0 Theoretical Framework

The following are some examples of modern financial management theories formulated on principles considered as 'a set of fundamental tenets that form the basis for financial theory and decision-making in finance' by Emery et al (1991)

### 2.1 Agency Theory

Agency theory deals with the people who own a business enterprise and all others who have interests in it, for example managers, banks, creditors, family members, and employees. The agency theory postulates that the day to day running of a business enterprise is carried out by managers as agents who have been engaged by the owners of the business as principals who are also known as shareholders. The theory is on the notion of the principle of 'two-sided transactions' which holds that any financial transactions involve two parties, both acting in their own best interests, but with different expectations.

Emanating from the risks faced in agency theory, researchers on small business financial management contend that in many small enterprises the agency relationship between owners and managers may be absent because the owners are also managers; and that the predominantly nature of SMEs make the usual solutions to agency problems such as monitoring and bonding costly thereby increasing the cost of transactions between various stakeholders (Emery et al.1991).

Nevertheless, the theory provides useful knowledge into many matters in SMEs financial management and shows considerable avenues as to how SMEs financial management should be

practiced and perceived. It also enables academic and practitioners to pursue strategies that could help sustain the growth of SMEs.

### 2.2 Signaling Theory

Signaling theory rests on the transfer and interpretation of information at hand about a business enterprise to the capital market, and the impounding of the resulting perceptions into the terms on which finance is made available to the enterprise. In other words, flows of funds between an enterprise and the capital market are dependent on the flow of information between them. (Emery et al, 1991). For example management's decision to make an acquisition or divest; repurchase outstanding shares; as well as decisions by outsiders like for example an institutional investor deciding to withhold a certain amount of equity or debt finance. The emerging evidence on the relevance of signaling theory to small enterprise financial management is mixed. Until recently, there has been no substantial and reliable empirical evidence that signaling theory accurately represents particular situations in SME financial management, or that it adds insights that are not provided by modern theory (Emery et al.1991).

### 2.3 The Pecking-Order Theory

This is another financial theory, which is to be considered in relation to SMEs financial management. It is a finance theory which suggests that management prefers to finance first from retained earnings, then with debt, followed by hybrid forms of finance such as convertible loans, and last of all by using externally issued equity; with bankruptcy costs, agency costs, and information asymmetries playing little role in affecting the capital structure policy. A research study carried out by Norton (1991b) found out that 75% of the small enterprises used seemed to make financial structure decisions within a hierarchical or pecking order framework .Holmes et al. (1991) admitted that POF is consistent with

small business sectors because they are owner-managed and do not want to dilute their ownership. Owner-managed businesses usually prefer retained profits because they want to maintain the control of assets and business operations.

This is not strange considering the fact that in Ghana, according to empirical evidence, SMEs funding is made up of about 86% of own equity as well as loans from family and friends(See Table 1). Losing this money is like losing one's own reputation which is considered very serious customarily in Ghana.

The 1971 Bolton report on small firms outlined issues underlying the concept of 'finance gap' (this has two components-knowledge gap-debt is restricted due to lack of awareness of appropriate sources, advantages and disadvantages of finance; and supply gap-unavailability of funds or cost of debt to small enterprises exceeds the cost of debt for larger enterprises.) that: there are a set of difficulties which face a small company. Small companies are hit harder by taxation, face higher investigation costs for loans, are generally less well informed of sources of finance and are less able to satisfy loan requirements. Small firms have limited access to the capital and money markets and therefore suffer from chronic undercapitalization. As a result; they are likely to have excessive recourse to expensive funds which act as a brake on their economic development.

#### 2.4 Leverage

This is the term used to describe the converse of gearing which is the proportion of total assets financed by equity and may be called equity to assets ratio. The studies under review in this section on leverage are focused on total debt as a percentage of equity or total assets. There are however, some studies on the relative proportions of different types of debt held by small and large enterprises.

#### 2.5 Equity Funds

Equity is also known as owners' equity, capital, or net worth. Costand et al (1990) suggests that 'larger firms will use greater levels of debt financing than small firms. This implies that larger firms will rely relatively less on equity financing than do smaller firms'. According to the pecking order framework, the small enterprises have two problems when it comes to equity funding [McMahon et al. (1993, pp153)]: Small enterprises usually do not have the option of issuing additional equity to the public. Owner-managers are strongly averse to any dilution of their ownership interest and control. This way they are unlike the managers of large concerns who usually have only a limited degree of control and limited, if any, ownership interest, and are therefore prepared to recognize a broader range of funding options. Modern financial management is not the ultimate answer to every whim and caprice. However, it could be argued that there is some food for thought for SMEs concerning every concept. For example Access to Capital and POF are really eye-openers for SMEs in Ghana to carve their way into sustaining their growth.

According to Kimuyu and Omiti (2000), Micro and Small Scale Enterprises are reputed for being behind most of the social-economic transformation in Kenya where they have contributed a great deal to the development process through employment and wealth creation. Some commercial banks in Kenya have a number of schemes targeting the MSEs. The schemes range from subsidized credit guaranteed by donors. Other actors include Non Bank Financial Institutions, Development Financial Institutions, NGOs, Government of Kenya and Rotating Saving and Credit Association (ROSCAS) (Wanyiru 1998). However despite all these micro finance lenders, limited access of MSEs to credit and financial services is one of the biggest challenges facing MSEs in Kenya and the current trends show that this has persisted (Dondo, 1995).

MSEs are generally undercapitalized, suggesting major operational difficulties in accessing credit and pursuing corporate goals. Kimuyu and Omiti (2000) observe that 18.4% of the MSEs in Kenya cite access to credit as their second most severe constraint after market access. Further the 1999 National Baseline survey (International Centre for Economic Growth et al. 1999) indicates that 70% of the MSEs in Kenya require loans that do not exceed Kshs. 20 000 (US\$ 285) while 96.3% do not require loans exceeding Kshs.100 000 (US\$ 1428). Ondiege (1996) demonstrated that access to credit is associated with improved performance of MSEs in Kenya. Moreover, Lundvall et al. (1998) show that manufacturing enterprises in Kenya that have limited access to credit also tend to be less productive and cannot always move to points of best practice. This indicates that since the MSE sector does not have adequate access to credit, its potential role in transforming the country is unlikely to be realized.

Lack of credit is the most severe problem faced by MSEs. Most of the MSEs use own funds and family resources as source of initial and additional capital. Although most often MSE entrepreneurs acquire their capital from their own savings or from family members, they also resort to traditional banking (merry go round) and table banking to meet their capital requirements. Considering the very low incomes and savings rate in the country, MSEs fall back on these sources of credit out of desperacy, the reason why they close down after a few month in business Nevertheless, as a result of their weak financial base, MSEs are regarded as high risk areas and as much do not succeed in attracting enough loans (Beneye, 2002).

## 2.6 Review of variables

### 2.6.1 Interest rate on credit

Every business needs financing, even though at first glance it appears that funding is unnecessary. It is important that financing be as efficient as

possible, Stutely (2003). Stutely urges that the borrower should be able to put the cost of all financing on the same basis, comparing them and come up with the one that gives the lowest cost financing option. Banks have often been criticized for having high interest rate charged on loans. But sometimes there are factors beyond their control. For example the amount of interest payable on loans depends on interest rate charged which is driven by the base lending rate of interest set by the central bank of Kenya.

The rate of interest charged on the credit determines the cost of credit. The cost credit is the amount the borrower is obligated to pay above the principal sum of the money lent. Saleemi (2007) defined interest rate as the return on capital. Cost of credit can be classified as gross and net interest. Interest rates are usually as the percentage of the borrowed amount. High interest rates increase the cost of credit. High interest rates on credit may discourage SMEs from borrowing reducing the accessibility of credit among them.

### 2.6.2 Education, Training and Access to Credit

Lack of knowledge of the rights that women have and how to enforce them is a challenge. Women may not be aware of the legal issues that they need to address to start a business, and they can find it difficult to navigate the complex array of laws and regulations. Education equips women with the knowledge and skills they need to more effectively manage and succeed in their businesses. Research shows that the level of formal entrepreneurial activity among women increases as their education rises, and there a major jump in business ownership among those who go beyond secondary education.

Education and skills are needed to run a business. Majority of people carrying out SME's in Kenya are not quite well informed in terms of education and skills. According to King and McGrath (2002), those with more education and training are more likely to be successful in the sector. The

literacy level was reflected in their ability to carry out managerial routines. The routine includes making decisions on financial investment and management. This influences the decision on the external funding of his enterprise.

According to ILO (2009) most of the Entrepreneurs have Low literacy levels as majority of them drop from the primary level or they have acquired primary level. This makes an entrance to the 'the jua-kali' sector increasingly the last resort for the disadvantaged students with relatively low levels of education. ILO (2009) observed that an entrepreneur's level of education is directly correlated with his ability to make financial decisions of his business.

ILO (2009) noted that declining level of education had negative influence on entrepreneur's ability awareness on how and where to get loans to improve their businesses. With low ability to read and write, therefore an entrepreneur is at a disadvantage in the loans market. Information on availability of loans, and the rate of interests charged, is communicated through newspapers, in which a good level of literacy is required to read and interpret.

Ndubi and Karanja (2008) Noted that; complete, accurate and precise information is necessary for financial decisions including obtaining business loans. The literacy level is again observed in the ability to have appropriate book keeping skills. The banks often demand cash flows and other financial records as a prerequisite for approving of credit.

Due to low literacy levels most SME traders are unable to differentiate the loan products offered by the financial institutions. Also since most of these services are offered in banking jargons, most traders are discouraged from applying for the loans (Ayodele, 2006). Further inadequacy in financial management skills and strategic planning put the SME's in a disadvantaged position in

competing with a large firms which are run by well-educated professional managers.

Most lenders advertise their services on the print media. Since the literacy levels among the small scale traders are low they may not access the information. Others may have general literacy but are not well informed, on the effect of credit facilities on business growth, and therefore may fail to ask for the services. The literacy level may therefore be a constraining factor in the access to, among traders. Lower education levels put Kenyan women entrepreneurs at a disadvantage compared to men. While the gender gap in primary education in Kenya has decreased in recent years, the gap remains high at secondary and tertiary education levels (Kamau,2009). Women are much less likely to enroll in public universities, national polytechnics, 21and technical institutes, and accounting for only about 39 percent of those enrolled in tertiary education.

### **2.6.3 Demand for Collaterals by financial institutions**

According to Kamau (2009) collateral security is again highlighted as a major constraint to credit access. In his survey, Kamau (2009) found out that 92% of the enterprises studied had applied for loans, and were rejected while others had decided not to apply since they 'knew' they would not be granted for lack of collateral security. Therefore, while most of the entrepreneurs, in this study recognized the importance of loans in improving their businesses, they cited collateral security as a major impediment to loan access and therefore hindering business growth. Almost all respondents started their Businesses from their own savings or loans from relatives since they did not demand security. Beaver (2002) explains that the historical development and the associated culture, of the banking system.

Under pin the problem of the emphasis on the provision of Collateral security as a primary condition in lending. Banks have always adopted

a risk averse stance towards small firms, with an accompanying inability to focus on the income generating potential of the venture, when analyzing the likelihood of loan repayment.

Therefore, although there has been a considerable progress in the lending to the SME's, banks still remain cautious because many these businesses have neither, collateral security nor asset registers. Most banking institutions demand collateral security as one of the requirements for the access to credit facilities. This becomes a constraint to SME's most of who may not have deeds to capital assets to present as security against the loans.

This factor reduces access to these loans. Furthermore, most lending institutions are more inclined to lending to the large scale businesses which have higher success rate, and repayment rate. The small scale businesses are relegated to the micro finance institutions (MFI's) and 'shylocks' whose lending requirements may further discourage them. Moreover, several MFIs and Youth Service Organizations (YSOs) have noted that because many youth work informally, it is difficult for them to provide acceptable confirmation of their earnings. Therefore, some Collateral security or Collateral security substitutes are required to make loans accessible to youth. The type of Collateral security required, however, can be a potential barrier for youth in accessing micro finance (Sauve, 2003. Owning title deeds as Collateral security to finance expansion is still a hurdle for most women entrepreneurs, given that property is not usually registered in their names (GoK 2009). Despite the existence of many MFI's and other financial institutions which have been lending their services for the last two or so decades, accessibility by most of the majority of the women is limited. This limited access to financial services is mostly attributed to the fact that women as compared to men, do not inherit properties from either their parents or their husbands due to social and cultural practices referred to here as gender

biasness which have led to lack of equal opportunities in education and employment opportunities, lack of enough income to acquire their own Collateral Securities just to mention but a few. It is against this backdrop of financial constrains that WEF was instituted with the aim of availing opportunities specifically among the women in accessing the financial services to uplift their standard of living and ultimately reduce poverty levels nationally. The basic consideration by Government of Kenya (GOK) for establishing WEF is to support women to have access to affordable capital to develop their entrepreneurial activities into thriving businesses (Government of Kenya, 2006).

#### **2.6.4 Credit Reference Bureau**

The first known credit bureau, the Mutual Information Society, was established in 1803 in London by a group of tailors to exchange references on the paying habits of their customers. The first credit bureau in the United States was established in Brooklyn in 1869. Credit bureaus are now operating in over 50 countries and their presence is increasing rapidly (Guillermo Bolaños, 2000). Credit markets present asymmetric information problems. Lenders know neither the past behavior and the characteristics, nor the intentions of credit applicants. This creates a moral hazard problem that causes lenders to make credit decisions based on the average characteristics of borrowers rather than on individual characteristics (Rothschild and Stiglitz, 1976). Moral hazard implies a lower average probability of payment, making credit more expensive. Higher interest rates exacerbate another informational problem, adverse selection, because only higher risk borrowers are willing to accept loans at high interest rates (Stiglitz and Wise, 1981). Additionally, precisely those borrowers that have defaulted with a particular lender are the ones looking for alternative credit sources (Akerlof, 1970). This increases the average risk of lending and the corresponding

interest rate. Credit is hence allocated to excessively risky projects, and low risk borrowers face tighter credit constraints.

The liberalization and the volatility of financial markets, increased competition, and diversification expose banks to new risks and challenges, requiring the continuous innovation of ways to manage business and its associated risks in order to remain competitive. The increasing market orientation of banks has also necessitated changes in the approach to regulation and supervision (Sonja Brajovic Bratanovic, 1999). It is against this theory that the Central Bank of Kenya initiated and introduced the CRB as a policy to be implemented by all commercial banks in Kenya with a view of improving credit risk management in the banking sector. Credit Reference Bureau is defined as a legal entity established as a company that allow financial institutions to exchange information on their clients' repayment history and debt profiles and which compiles a database that collects, stores, consolidates and processes information related to persons, companies and enterprises (FIA, 2004).

The basic function of a credit bureau is to enable banks share information about borrowers for business decision making i.e. credit granting decisions. The bureau also keeps a credit history record of the borrower and can even assign a score related to the credit history. Good credit scores can ease access to more credit which could be an opportunity for SMEs to access credit without the restrictive collateral requirements.

Yuko Nikaido (2015) did a study on what hinders and what enhances small enterprises' access to formal credit in India? Results indicate that enterprise size, owners' education level, being registered under an agency and being involved in diversified activities are positively associated with access to formal credit. However, the ownership of land that can be used as collateral is negatively associated with the likelihood of receiving formal

credit. This may be due to an obsolete land administration system resulting in high transaction costs of land as collateral.

A study was done by Fatawu Alhassan & Ahmed Sakara (2014) On Socio-Economic Determinants of Small and Medium Enterprises' (Smes) Access to Credit from the Barclays Bank in Tamale-Ghana. The results indicated that, the number of employees, experience in credit use, number of fixed assets possessed, attitude towards risk, business size, form of business and sector of business in the economy are the critical success factors in accessing bank finance. The study also identified Management expertise, high default rate and monitoring as the challenges banks faced in giving credit to SMEs. In terms of policy, the findings of this study will provide banks, training institutions and policy makers with new insights on investigation of loan evaluation process, tailoring new training programmes for entrepreneurs and developing relationships with business associations.

Joseph Kofi Nkuah (2013) did a Study on Financing Small And Medium Enterprises (Smes) In Ghana: Challenges and Determinants in Accessing Bank Credit. The major findings for the study indicated that there exist significantly, positive relations between certain attributes of a firm and access to credits. There are also, some financial activities such as business registration, documentation/recording, business planning, asset ownership, and others that also impact heavily on SMEs access to bank credits.

Huka Sharu (2013) did a study on Factors Influencing Growth of Youth Owned Small and Medium Enterprises in Nairobi County, Kenya. The study established that entrepreneurial skills influence the growth of youth owned SMEs most followed by market access, government policy and credit access. The study established that some of the youth who had started SMEs had no training in business. This study therefore

recommends that the government of Kenya should set up conferences and seminars to train entrepreneurs on business planning, book keeping, marketing, financial management and customer relations. The study established that a good number of SME owners did not have access to credit. It recommends that financial institutions should consider reducing their requirements to fund the youth in their businesses. The study found that short repayment period and high interest rates were a challenge in obtaining a loan for their business. It recommends that financial institutions should increase the loan repayment period and reduce the interest rates. It was established that government policies like business registration process, licensing and registration requirements and certification from various ministries affect the growth of SMEs negatively. The study therefore recommends that the government of Kenya should reduce the cost and smoothen the process of licensing and business registration.

Daniel Nderi Waari (2015) in his a study on Factors Influencing Access to Finance by Micro, Small and Medium Enterprises in Meru County, Kenya revealed that information asymmetry, business risks and transactional costs influence access to finance.

John Gakuu Karanja (2014) in his study on the Analysis of Factors Influencing Access to Credit Services by Women Entrepreneurs in Kenya established that Lending procedures were found to be rigid and does not accommodate the needs of women entrepreneurs. Collateral requirements that the FIs have adopted do not attract women entrepreneur borrowers to seek credit service, .the effect of inflexibility in the lending amount by the FIs affects the demand for credit services by women borrowers, and it was also found that various aspects of the purpose of the loan were agreed among many respondents (above 50%) to be not favorable and does not attract women entrepreneurs.

### **3. RESEARCH METHODOLOGY**

#### **3.1 Research design**

The study utilized a descriptive survey design with the aim of achieving the objectives of the study. This design was considered appropriate tool for collecting information for the goals of the research called for both quantitative and qualitative data. This study collected data on SME's access to credit facility which is essentially qualitative. Descriptive research is concerned with conditions or relationships that exist, practices that prevail, processes that are ongoing, attitudes that are held or trends that are developing (Best, 1970). Surveys are one of the popular research methods used in educational research because information from a small sample can be generalized to a large population

#### **3.2 Target Population**

According to the Kenya Bureau of Statistics (2009), Kitale town has a population of 106,187 people. The Municipality borders Kiminini division to the south, Kwana district to the west, Cherangany division to the North and Waitaluk division to the East.

The target population comprised of the 726 licensed SME's by the Kitale County Revenue Department. The research only targeted those SMEs registered by the Municipal Council, because their number and locations were known.

#### **3.3 Sampling Frame**

The sample was drawn from a target population of 726 licensed SMEs by the Trans-Nzoia County Government as at the time of the study. SMEs in existence and not registered with the County Government were excluded from the study

#### **3.4 Sample and Sampling technique**

Stratified random sampling technique was used to determine the sample size. Respondents were grouped in strata of Small and Medium enterprises

owners and random sampling technique used to get the intended respondents in each stratum.

Using the Krejcie and Morgan formula (Krejcie and Morgan, 1970) a sample size of 256 SME's was considered for the study. From this sample probability to proportion size was used to come up with the number of each respondent in each stratum. Given that Kitale town has few financial institutions (12) that provide credit facilities the managers of those institutions were purposively chosen to participate in the study.

### **3.5 Data Collection Instruments**

Two types of data collection methods were used namely primary data and secondary data collection methods. The primary data was collected directly from SME owners, qualitative interviews were conducted and questionnaires were used. Questionnaires were used to collect data from the SME owners. Questionnaires assisted in establishing the SME owners perception of CRB's in Kenya. These questionnaires had both open and closed ended items and were administered to all the 256 SME owners. A face to face interview was also used to collect data from credit lenders/ providers. Interviews have an advantage in that they allow the researcher to establish rapport with the respondents and it is time efficient, allows for acquisition of more in-depth information and promotes the highest response rate. The research sought information on the role the CRB's and how they affect the credit borrowers.

### **3.6 Data Collection Procedures**

On approval of the proposal by the Department of Finance and the school of Human resource, an approval letter was obtained from the School of Graduate Studies of Jomo Kenyatta University of Science and Technology's. The letter was used by the researcher to acquire a research permit from the National Council of Science and Technology. The questionnaires were hand delivered by the researcher and one hired research assistant to the

SME owners and given time of around 15 minutes to respond to the questions. The questionnaires were administered in a period of two weeks.

Given that managers of financial institutions that provide credit to SME's are few in number the interviews were only conducted by the researcher. Before the interview the respondents were given an initial introductory and motivating talk by the researcher to prepare them psychologically and also to inform them of the rationale for the study. This, however, was as brief as possible to save on time.

### **3.7 Validity of the instruments**

Three aspects of validity were determined for the instruments. Face validity was established by assessing the items on the instrument and ensuring that they appear relevant, meaningful and appropriate to the respondents. Content validity was determined by the supervisor who looked at the measuring technique and decided whether it measured what it intended to measure. He carefully examined the items on the instruments and ascertained that the instruments contained adequate traits expected to measure the domain under study. Construct validity was obtained by correlating the scores on one instrument with scores from another instrument.

### **3.8 Data Processing and Analysis**

The data collected from SME owners was analyzed using a statistical package of social scientists software (SPSS) taking cognizance of their serial numbers and codes of each item. Data analysis included the use of descriptive and inferential statistics. Descriptive statistics involved the use of frequency tables, pie charts, graphs and percentages. The inferential statistics involved correlation analysis.

## **4. FINDINGS**

### **4.1 Gender of the respondents**

The sampled respondents comprised of 168 male and 72 female. Therefore, there were more male owned SMEs, accounting for 70% percent, as compared to 30% percent female owned SMEs. A further analysis was done to establish the relationship between the gender of the owner of the SME and access to credit. The relationship established showed a negative relationship of -0.496. The gender of staff in the banking sector was also considered as a possible factor that would influence access to credit among SMEs. Data analyzed on the relationship between the gender of staff in the banking sector and an SME's access to credit established a negative relationship of -0.312.

#### 4.2 Age of the Respondents

It was noted that 112 (50.8%) of the SME respondents were aged 31-35 years, 77 (32%) aged between 26-30 years, 42 (17.5%) aged 21-25 years while 9 (3.8 %) aged less than 20 years.

#### 4.3 Education Levels

It was found that 44.5% of the respondents had attained secondary school certificate as their highest academic qualification, 25.8% had attained college certificate, 17.5% had primary school level, 17.5% had standard eight certificate while the rest 3.7%) had had university degrees as their highest level of education. This depicts that most of the young entrepreneurs had low levels of education as regards entrepreneurship and business management hence they are not capable to manage their businesses effectively.

#### 5.0 CONCLUSION

The first objective was to find out how lending procedures affect access to credit by small and medium scale enterprises in Kitale Town. The study established that lending procedures contributes 37.5% variability to SMEs access to credit facilities from microcredit institutions when other factors are held constant.

The second objective of the study was to find out how collateral requirements influence access to credit by small and medium scale enterprises in Kitale Town. The findings of the study reveal that collateral contributes 18% variability to SMEs access to credit facility from financial institutions when other factors are held constant

The third objective of the study was to establish the relationship between the credit bureau referencing policies and access to credit by SMEs in Kitale town. The analysis results revealed that Credit Bureau referencing Policies contributes 35.7% variability to non access of credit facilities by financial institutions.

Finally the study sought to find out the influence of education and entrepreneur training and access to credit by SMEs in Kitale town. Results from the study show that training offered by finance Institutions contributes 12.3% variability in access by SME from financial institutions when other factors are held constant

#### 5.1 Recommendations

In view of the findings of the study, the following suggestions can help enhance credit accessibility of SMEs from the formal financial institutions.

First of all, with regards to the area of financial characteristics of SMEs which hinders their access to credits, it is suggested that all small and medium scale enterprises in the metropolis develop voluntary interest in such legal activities as business registration, accurate documentation of business transactions, appropriate and clear business planning so that, it situates their ventures in the best positions to access finance to boost their operations. This is because, lending in itself is a risk and to advance a loan to a business which is not legally recognized is riskier for financial institutions. Therefore, business registration and good business conduct would attract financial institutions' interest to do business with SMEs and to aid their growth through loan packages.

With regards to asset ownership and collateral securities, financial institutions are advised to consider other alternatives such as partnering with SMEs to finance the venture. This could take the form of banks assessing the profitability of the venture and financing the operational needs as well as expansionary needs of the venture accordingly with an agreeable interest in the venture. Even though, this process will break the sole proprietorship aspect of SMEs, it is only for a short time (say, one or two years) within which the financial institution will only act as an agent of growth, thereby producing the financial needs as well as the managerial advices necessary for the growth of the venture. This will however bring together financial institutions and SMEs in business hence, a better platform to understand each other's mode of operations. This joint venture will also influence the interest rates to be applied to SMEs in order to ensure their interest on loans and the ability to repay loans.

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