DETERMINANTS OF ACQUISITION OF FINANCIAL SERVICES BY MICRO AND SMALL ENTERPRISES IN LANGATA SUB-COUNTY OF NAIROBI COUNTY, KENYA

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DECLARATION

This thesis is my original work and has not been presented for a degree, in any other university or any other award.

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DEDICATION

Dedicated to my beloved family: wife Martha, sons Kevin and Edwin and daughters June and Louisa.

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OPERATIONAL DEFINITION OF TERMS

Commercial Banks	-	Financial institutions accepting deposits.
Enterprise	-	Shops, trades and services operating as economic activities with up to 50 employees.
Entrepreneurs	-	The business owners/mangers of micro and small business enterprises.
Financial Services	-	Loans and credit facilities from banks and microfinance Institutions.
Growth	-	Increase in firm size, sales value, profitability and asset values of Micro and Small enterprises.
Informal sector	-	Retailers, manufacturers, distributers, caterers, motor vehicle repairers, importers and exporters, commission agents, wholesalers, education institutions and others.
'Jua Kali'	-	Open air business activities conducted by individual ownerships.
Lending	-	Providing loans and credit lines for goods and services.
Micro Enterprises		Businesses employing between 1-9 workers.
Micro and Small Enterprises	-	Enterprises in formal and informal sectors employing between 1 and 50 employees.
Other Financial institutions	-	Lending Institutions not accepting deposits from customers.
Performance	-	Volume of sales with a given capacity of business.

ABBREVIATIONS

ASCAS	-	Accumulating Savings and Credit Associations
DFI	-	Development Finance Institutions
GDP	-	Gross Domestic Product
GRJS	-	Gikomba Riverside Jua Kali Society
KNBS	-	Kenya National Bureau of Statistics
MDG	-	Millennium Development Goals
MEs	-	Micro Enterprises
MFI	-	Micro-Finance Institutions
MSE	-	Micro and Small Enterprises
NBF	-	Non-Bank Financial Institution
NCC	-	Nairobi City County
NGO	-	Non-Governmental Organizations
NSE	-	Nairobi Securities Exchange
ROSCAS	-	Rotating Savings and Credit Associations
SEs	-	Small Enterprises
SME	-	Small and Medium Enterprises
SSE	-	Small-Scale Enterprises
UK	-	United Kingdom
VAT	-	Value Added Tax

ABSTRACT

Globally Micro and Small Enterprises have been acknowledged as agents of economic development. They have been cited as being the seedbed to the medium and large enterprises. MSEs have been known for their crucial role in creation of employment, income generation and supplementing the provision for goods and services by large enterprises as well as eradication of poverty. The contribution of MSEs in the creation of wealth and support to the development and growth of medium and large scale enterprises has been enormous. In recognition of their contribution to development, several governmental and non-governmental agencies have been set up to support their activities. The failures of MSEs to recognize the important role played by external sources of finance usually pose a serious challenge to their functions. Since MSEs regularly suffer serious financial constraints, they are yet to realize their full potential as agents of economic growth. In Kenya for example, the failure rate of MSEs is still as high as 65 percent. The general objective of this study was to investigate the determinants of acquisition of financial services by MSEs in Langata Sub County of Nairobi County in Kenya. The specific objectives of the were to determine the relationship between legal and regulatory framework, level of education and entrepreneurial training, demographic factors as well as economic factors and acquisition of financial services by MSEs in Langata Sub County. The study design was descriptive with a target population consisting of 2,098 micro and small enterprises. A sample size of 250 businesses was determined through stratified random sampling technique by sector. Primary data on the selected businesses were collected using semi-structured questionnaires. The response rate was 231 firms representing 92.4 percent. Data was analysed using frequency distribution, chi-square tests, correlation analysis and multinomial regression analysis. The study found that there was a negative but significant relationship between legal and regulatory framework, level of education and entrepreneurial training and acquisition of financial services by MSEs. Demographic factors also had a negative but significant relationship with acquisition of financial services by MSEs in Langata. For practice the study recommended that: firstly, accessibility to financial services can be enhanced by financial intermediaries and the government by working on a framework that relaxes the complexities in loans acquisitions. Secondly the government should enhance entrepreneurship financial training, including cascading it through formal education system and thirdly, financial services providers should develop financial products that are inclusive enough to carter for the different demographic groups.

CHAPTER ONE

INTRODUCTION

1.1.Background to the Study

Micro and Small Enterprises (MSEs) are not new in the history of economic development. The micro and small businesses had been there much earlier (Berislav, 1985). Since their recognition as economic agents, governments and non-government agencies developed strong interest in the development and growth of MSEs by starting various schemes to support the sector activities (Akaplu, 1978). Berislav (1985) further pointed out that large scale industries had their origin in small business units though recognition of small businesses activity as a determining factor of economic development came much later in the 1950s. The MSEs were recognized for their role and importance in economic development and growth of economies. Since then, there has been a growing interest in the development of small businesses worldwide. This has enabled small businesses to continue playing a critical role in the development of economies, particular, in the developing economies like Kenya.

Leegwater and Show (2008) observed that MSEs are found across all the sectors of the economies ranging from agriculture, manufacturing and trade stating that MSEs are incubators for Small and Medium Enterprises (SMEs), thus making them contributors to the economic growth.

Leegwater and Show (2008), further observed that Micro Enterprises (MEs) are the link in the sector-specific value chain as the supply base of SMEs. The potential of these size businesses, however, have not been realized to the fullest. The MSEs have performed fairly well in some countries while in other countries the performance of MSEs has not been good.

In the United Kingdom (UK), small enterprises are recognized as the backbone of the British economy accounting for more than 50 percent of the turnover (Lukacs, 2005). From the household point of view, the MSEs, aim to raise income of the poor households and thereby reduce poverty (Thapa, 2007). In many situations these entities are family owned businesses. 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 and Kappel, 2008).

In Kenya, MSEs, are reputed for their contribution of jobs accounting for over 50 percent of new jobs (Bowen *et al.*, 2009). In South East Asia MSEs are in fact reputed to be behind most of the socio-economic transformation which created the new economic giants, also known as the Economic Tigers. In Bangladesh, a large proportion of all the establishments are accounted for by SMEs (Islam *et al.*, 2011). The performance of MSEs in some regions looks while in others the performance is not as good. In South Africa for example, 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. Luck 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. But economic output of micro enterprises in South Africa is believed to be as high as 50 percent of the GDP and absorbing an estimated 60 percent of the labour force. In China, the role of the small enterprises is even more impressive. Kamitewoko (2013) found that the Chinese-Owned Businesses in Congo Brazzaville contributed significantly to the workforce in that country citing finance as key player in their success. Hepeng (2014) found that the small and medium-sized enterprises provided close to 75 percent of the town employment opportunity by the end of 2012.

The MSEs, World over are important as agents for wealth and employment creation and poverty reduction. During their early stages of development, they form the seedbeds to both the medium and large scale enterprises. Since they exist in all the geographical areas including rural and urban areas MSEs, link the rural and urban markets. Besides, MSEs also supplement the markets by supplying goods and services that the medium and large enterprises are not willing to be engaged with.

In Kenya, the important role played by MSEs in the economy had been recognized since the sector was brought into limelight in 1972, in a report by International Labour Organization (ILO) / United Nations Development Programme (UNDP) on employment, income and equity in Kenya (Sutheraman, 1976; Mullei and Bokea, 1999). The importance of MSEs in Kenya's economy had even been noted earlier by the many papers and discussions on Kenya informal sector (Abuodha and King 1991). Kenya's first step in the development of the small enterprise sector was by the development of Sessional Paper No. 1 of 1986. Secondly, the role played by MSEs was recognized in the 6th National Development Plan (1989 – 1993), as a primary means of strengthening Kenya's economy. In the 6th Plan, the target for new employment creation over the five-year period was 1.9 million jobs. Of those jobs, approximately 31 per cent or 587,000 jobs were expected to be created in the Small- Scale and *Jua kali* enterprise sector (Republic of Kenya, 1992). From the African economic point of view the informal sector accounted for some 60 percent of the urban labour force in low income Africa and contributed 20 percent of their GDP (UNDP, 1996).This further explained the importance of MSEs in world economies. But the survival of MSEs is surrounded by a number of challenges including lack of access to and acquisition of financial services, high cost of production, marketing, poor quality of tools and pricing. Lack of access or acquisition of financial services is often quoted as a contributor to business failure among other factors.

MSEs in both formal and informal sectors are classified into farm and non-farm categories (Republic of Kenya, 2004). In a nutshell, these enterprises cut across all sectors of the Kenyan economy and provide one of the most prolific sources of employment creation, income generation and poverty eradication.

The MSE sector is not only a provider of goods and services, but also as a driver in promoting enterprise culture which is necessary for private sector development and industrialization. The contribution of MSE sector for Kenya's GDP has been quite impressive increasing from 13.8 percent in 1993 to over 18 percent in 1999. The performance and competitiveness need to be increased if it has to effectively respond to the challenges of creating productive and sustainable employment opportunities, promote economic growth and poverty reduction in Kenya (Republic of Kenya, 2004). One way of improving MSE performance would be by improving their access to financial services.

The sector has continued to play an important role in the development of the country. The sectors' impact can be seen further in terms of its contribution towards economic growth, employment creation, poverty alleviation and development of an industrial base. The economic survey (Republic of Kenya, 2003) indicated that employment within the MSE sector increased from 2.4 million persons in 2000 to 5.1 million persons in 2002, accounting for 74.2 percent of the total persons engaged in 2002. This implied that with proper development strategies, the sector was capable of providing and surpassing the government's target of creating 500,000 jobs per year (Republic of Kenya, 2005). In addition, the sector contributed up to 18.4 percent of the country's Gross Domestic Product (GDP). To be able to continue providing these important services MSEs needed to be supported in every manner to get off their feet.

The financial sector has gained popularity amongst the youth particularly in Nairobi and other urban centers as well as the rural areas. The youths who fail to get formal employment choose to join MSE businesses as an alternative to form of employment. Those who find themselves in this sector operate under unconducive environments. Mostly businesses are individually owned and operate in temporary structures. The entrepreneurs who are manufacturing use poor tools in a very competitive market. Most of the time there is fear of calamities such as fire outbreaks as well as destruction of premises by council authorities. In order for the MSEs to improve their performance and enlarge employment opportunities as well as increase types of goods and services, the entrepreneurs should be able to acquire adequate financial services. This will make the industry more competitive.

1.1.1. Acquisition of the Financial Services by MSEs

Every enterprise requires financial services for their development and growth. For all enterprises adequate financial resources is a must. Adequate financial resources make enterprises different from what they would have been without the financial services. Enterprise resources can be supplied either by the proprietors or outsiders. Credit has been identified as one of the most important financial service for the firm growth, without which various inputs like physical capital, labour and raw materials may not be purchased (Aketon, 2007). In both the developed and developing countries, finance has been identified as the most important factor determining the survival and growth of Micro and Small Enterprises (MSEs) (UNDP, 2008). Yet, MSEs are mostly credit constrained.

Banks are the most competent providers of financial services as observed by Adedoyin and Adekanye (1992). The banks have a pool of funds out of which they give out consumer loans to individuals and commercial loans to enterprises and to government through purchase of securities. As firms grow they turn to formal financial institutions for financial needs starting with banks (Watchel, 2001). But firms do not need finance for growth only. Firms need finance for start up as well. For MSEs, acquisition of financial services especially loans from banks has not been easy (Atieno, 2001).

Banks and other financial institutions play intermediary role by moving money from savers to borrowers. When banks and other financial institutions fail to perform one of their intermediary roles, they cause insufficiencies and disrupt the economy (Croushore, 2007). This would then force particularly operators of MSEs to continue sourcing financial services from informal lenders.

Kenya has a fairly well-developed financial system and various financial products (Central Bank of Kenya, 2013). The sector has experienced a tremendous growth since 1998 and contributes significantly to the Kenya's economic development. The numbers of the banking and other financial institutions have continued to vary over time. The financial sector was recognized as the fifth largest sector in Kenya by the year 2003; however, its ability to contribute effectively to the development process has been undermined by non-performing loans (Republic of Kenya, 2003). The existences of non-performing loans perhaps have made the financial institutions shy away from providing financial services to some sectors and individuals.

By 2006 a number of commercial banks had taken to increase financial services and products to the majority of Kenyan population (Republic of Kenya, 2007). The financial institutions had put in place strategies to expand their outreach to rural areas as well as urban centres. Between the years 2006 and 2007, the banking sector network increased by from 575 branches to 740 branches. In spite of this increase in the branch network, the level of access to financial services by MSEs was still low though some commercial banks had started programmes targeting MSEs (Republic of Kenya, 2007).

The baseline survey of 2006 on financial access in Kenya indicated that majority of Kenyans still use informal providers of financial services like Accumulating Savings and Credit Associations (ASCAs) and Rotating Savings and Credit Associations (ROSCAs) (FSD Kenya, 2007). It is on the basis of this background that this study sought to investigate the determinants of acquisition of financial services by micro and small enterprises.

As a result of the reforms in banking sector in Kenya up to the year 2013, the Kenya banking sector was comprised of the central bank as the regulating authority, 43 commercial banks, 1 mortgage bank, and 9 microfinance banks, 2 credit reference bureaus 1 monetary remittance providers and 101 forex bureaus (Central Bank of Kenya, 2013). But despite the large number of commercial banks and non- bank institutions, a number of MSEs and SMEs operators still found it difficult to access financial services.

The exclusion was at 25.4 percent and access to formal financial services at 67 percent (Central Bank of Kenya, 2013). This rate still left out a large number out of the reach of financial services.

Compared to the developed countries, it can be observed that access to credits in the developed countries is much higher than in developing countries. A study by Aketon (2007), micro and small enterprises in Kenya revealed that 71 percent of the surveyed firms did not apply for loans. Only 24 percent applied and received the loans, while 5 percent applied but did not get. This suggests that the 71 percent did not need the loan, feared or had no idea of where to apply for loans.

In the developed countries, private credit as a percentage of gross domestic products (GDP) is 85 percent. In upper middle – income it id 30 percent and in lower- middle it is 25 percent while in lower – income nit is 12 percent (UNDP, 2008). This is an indication of high credit participation. In such cases, the Micro, Small and Medium enterprises (MSMEs) access less of the informal services which are often exploitative.

The government recognizes that access to credit and financial services is key to the growth and development of any enterprises and, more so to the MSEs, not much effort had been given to improve the position (Republic of Kenya, 2005). This situation appears to be getting worse by the time as indicated by past studies.

Ondiege (1992) reported that only 2 percent of MSEs accessed credit. The baseline survey of 1993 (Republic of Kenya, 1993), indicated that 9 percent of MSEs had accessed credit, a small increase of 7 percent. But out of the 9 percent only 4 percent was obtained from the formal financial institutions. The baseline survey of 1999 indicated that 89.6 percent of MSEs did not access credit (Republic of Kenya, 2009). This result, indicated a higher non – involvement of credit by MSEs compared to 85 percent and 89.2 percent in 1985 and 1995 respectively.

As indicated earlier by Ongile (1994), in the periods 1990, 1991 and 1992 there was a small increase in the amounts provided to 24 SMEs of Shillings 115 million, Shillings 211 million and Shillings 241 million respectively. But Oketch *et al.* (1995) studied that although the supply increased later from some 50 organizations to shillings 847 million, the increase did not significantly influence accessibility of credit by MSEs. World over, lack of access to bank credits has been cited by MSEs as the biggest constraint (Oketch 1991, UNDP 2008 and FSD Kenya, 2008). FSD Kenya (2008) indicated that 83 percent of micro enterprises did not even apply for loans as compared to 39 percent of the Small Enterprises (SEs). Further, it was observed that only a small number of formal financial institutions address this market effectively.

MSEs are widely acknowledged as important economic agents to address issues regarding unemployment, wealth creation economic growth and overall economic development. But research has shown that many MSEs, start but fail often. Mead and Liedolm (1998) noted that MSEs failed when the economy is plummeting and expand to higher levels of productivity and employment gain when the economy is improving. A number for arguments have been put across for the slow growth in different countries. The state of the economy of a country has been argued to be one of the reasons for the status of MSEs in an economy. Mishkin (2009) stated that when there is improvement in the economy more funds become available for those who require it. Access to financial services would enable businesses to improve on the quality of products and to compete equally in the market yet lack of access to finance has been often cited as a contributor to failure by MSEs..

According to the Kenya National Bureau of Statistics (KNBS, 2007) as cited by Bowen, Morara and Mureithi (2009) three out of five businesses fail within the first few months of operation. Evidence has shown that finance is the most critical factor that has more impact on the growth MSEs (Beck *et al.*, 2010). Beck (2012), noted that the impact of financial sector deepening on firm performance and growth is stronger for small firms than the large enterprises. Fatoki (2014) pointed out that in South Africa New SMEs suffer ‘high rate of failure which paints a bleak picture of the country’s SME sector. In Kenya the situation is not very different from the rest of Africa and other developing economies of the world. It was against this background that this study was conducted.

1.2. Statement of the Problem

Finance is the nerve centre of every business. Every firm requires financial services for development and growth. Availability of financial services especially bank loans and credit facilities are believed could spur development and growth. In finance literature, access to financial resources is widely perceived to be an essential factor especially for Micro and small enterprises.

Inaccessibility to loans and credit facilities from banks and microfinance institutions has created a huge gap in financing MSEs in Kenya as access to financial services remained a major constraint (FSD Kenya, 2008). This has led to reliance on own savings and re-invested profits.

Studies by Thuranira (2009); Njanja, Pelisier and Ogutu (2010); Calice *et al*, (2012); Ntakobajira (2013); Njoroge and Gathungu (2013); Kimani (2013) and Ochanda (2014) showed that access to financial services is still a big challenge to the micro and small enterprises in Kenya. Due to inaccessibility to bank loans and other credits, most of the small businesses rely on own savings and reinvested profits. This makes the Owners and managers of MSEs to experience a big gap in acquiring financial resources since the savings and the profits are not adequate. As a result, majority of the small businesses find it difficult to grow while others actually fail.

Although Kenya has a well- developed financial system, bank and other financial institution lending to MSEs is yet to be realized to the fullest. Inaccessibility of financial services tends to make business operation costly as the business owner/mangers attempt to confront the challenge. Notably, micro and small enterprises have failed to recognize the importance of external sources of finance while other sectors of the economies have been able to access financial services from external sources. Continuation of this trend may not allow the micro and small businesses perform their pivotal role of creation of wealth and job opportunities, provision of services and goods, and poverty reduction.

Literature reviewed did not appear to indicate the factors that determine acquisition of financial services by MSEs. None of the literature also indicated the reasons as to why micro and small businesses would not apply for loans or seek other financial services from banks and other financial institutions. This was the gap in knowledge that this study had sought to fill.

1.3. The Objectives of the Study

The study was guided by both the general and specific objectives.

1.3.1 The general objective of the study was to examine determinants of acquisition of financial services by MSEs in the Langata sub-county in Nairobi County in Kenya.

1.3.2 The specific objectives were to:

i. Determine the relationship between legal and regulatory framework and acquisition of financial services by MSEs;
ii. Examine the relationship between education and training on acquisition of financial services by MSEs;
iii. Establish the relationship between demographic factors and acquisition of financial services:
iv. Analyse the relationship between economic factors and acquisition of financial services by MSEs;

1.4. Hypotheses of the Study

Ho_{1}: There is no relationship between Legal and Regulatory framework and Acquisition of financial services by MSEs in Langata Sub County.

Ho_{2}: There is no relationship between level of education and training Acquisition of financial services by MSEs from financial institutions by MSEs in Langata Sub County.

Ho_{3}: There is no relationship between demographic factors and acquisition of Financial services by MSEs in Langata Sub County.

Ho_{4}: There is no relationship between economic factors and acquisition of financial services by MSEs in Langata Sub County.

1.5. Significance of the Study

The findings of the study will enable the government to enact laws and make decisions which provide enabling environment for MSEs to grow and improve the national GDP and to enable the achievement of the vision 2030.

Banks, Financial Institutions (FIs) and other lending organizations could also rely on the findings of this study in making lending decisions as well as developing friendly and attractive terms for acquisition of financial services. A number of entrepreneurs who might have avoided banks and other financial institutions due to lack of adequate information will find it reasonable to seek financial services from the institution. Non-governmental organizations which have been crucial in providing credits to MSEs would channel some of the funds to other projects if the MSEs can make major roads to formal lending institutions.

The community stands to benefit from the study as a result of increased productivity and provision of services, job creation and eradication of poverty. The study will have immense contribute to literature for use by future researchers and also form a basis for further studies in the area of small and medium enterprises.

1.6. Scope and Organization of the Study

The scope of this study was limited only to micro and small enterprises operating in Langata sub-county in the Nairobi County. Many people moved into the Nairobi County in such of employment but end up engaging in micro and small business activities after failing to get the desired employment. The existence of non-performing loans seems to have made banks and other financial institutions to shy away from providing financial services to the MSEs because of the perceived risk. This has led to Langata sub-county being home to Kebera informal settlements which are believed to be the biggest informal settlement in Kenya and the world.

The study examined issues relating to acquisition of financial services by MSEs in Langata. The study concentrated in Langata because the sub county has various types of informal businesses ranging from schools, groceries, entertainment, services to manufacturing. The population of focus was those enterprises operating within the sub county. The issues of acquisition of financial services still remains one of the critical challenges to the development and growth of micro and small economic entities in Kenya. The time frame for the study was period between the year 2001 and 2011. In this period there were attempts to address issues relating to improvement of the micro and small enterprises. First was the Donde Act of 2001 on the control of banks interest rates. Later in 2003, came the Economic Recovery Strategy for Wealth and employment Creation. In

2006, the Government enacted the Micro Finance Institutions Act of 2006 to ease the pressure on MSEs on accessing bank loans.

The study was organized into five chapters. Chapter one of the study covered the background to the study, statement of the problem, objectives of the study, significance and; scope and organization of the study. In chapter two, the study covered theoretical literature, empirical literature, conceptual framework and summary and knowledge gap filled by the study. Chapter three covered the study philosophy, research design, model specification, study location, sampling and sample size, instruments used, pilot study and data analysis. Chapter four of the study covered empirical results, interpretation and discussion of the results. And lastly in chapter five the summary of the study, conclusions and policy implications are presented.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

In this chapter, theories relating to acquisition of financial services, historical development of and role of Micro and Small Enterprises in industrial and economic development as well as the importance of MSEs to economies were covered. The chapter also presents past studies which investigated possible link between certain factors and performance of MSEs and the conceptual framework that informed the study.

2.2 Theoretical Literature

There are several theories that explain why an investor would select a particular combination of sources of finance to finance business activities. This study was guided by three theories of loanable funds, liquidity preference theory and the pecking order theory. The three theories are discussed in detail to explain some of the factors that may have influence on acquisition of financial services.

2.2.1 Loanable Funds Theory

Borrowing from banks and other financial institutions is one of those ways through which firms and individuals can acquire external funding to finance their operations (Adekanye & Adedoyin, 1992). The individuals and institutions which have funds channel to those who need the funds. To persuade those supplying the funds in the market to provide the required funds to those who require the funds, there are cost charged on the funds disbursed. According to the loanable funds theory, the quantity of money supplied depends on the demand for money in the market (Mishkin, 2009). The supplied quantity of money will depend on the interest charged which is the price of financial service acquired when all other economic factors are held constant. Similarly, the quantity of money demanded in the market is a function of price and interest when other factors are held constant. When the price is low, interest will be high and the quantity supplied low. This would mean that less loanable funds will be available. But when the price increases, the interest falls and the supply increases. The market equilibrium is then obtained at the point where the amount people are willing to demand equals the amount that loan providers are willing to supply at a given price.

2.2.2 Liquidity Preference Theory

Liquidity preference theory as propounded by Keynes indicated that interest is purely a monetary phenomenon, because interest is calculated in terms of money. Interest in this case is the price paid for giving a way funds for a specific period of time. According to this theory lenders are risk averse and risk generally increases with length of time. Therefore, Lenders prefer to make short-term loans rather than wait for a long time, preferably to uncertainty. The lenders can only be induced to lend for longer periods of time by granting them higher interest rates (Joy, 1977; Pandey, 2003). The theory is closely related to loanable funds theory except that according to this theory, equilibrium interest rate is determined in terms of the supply of and demand for money (Mishkin, 2009).

Cash being the most liquid asset, people would like to keep their assets in cash. Therefore, when asked to surrender this liquidity, they must be paid a reward in the form of interest. An asset is considered liquid if the market in which it is traded has money buyers and many sellers. The greater the desire for the liquidity, the higher shall be the rate of interest for departing with the liquidity.

2.2.3 Pecking Order Theory

This study was on acquisition of financial services by MSEs in Langata Sub County in Nairobi County in Kenya. The study investigated the factors that could influence the decision of MSEs to finance their activities in a particular order. Pecking Order Theory was found to be one of the most relevant theories to this study since MSEs tend to finance their business activities largely by self then friends. Myers (1984) and Myers and Majluf (1984) developed this theory as an alternative explanation as to why a firm would select a certain capital structure. According to (La Rocca, La Rocca., and Cariola, 2009) the theory further suggested that firms should finance their needs in a hierarchical fashion. For MSEs in Langata Sub County, self-financing come first followed by loans from family members and friends. It explains how firms choose to obtain new financing for their future activities and growth. MSEs by their very nature are generally financed by self due to lack of accessibility to external financing like long term debt which is the basis of the Pecking Order Theory. The theory suggests use of internal sources followed by debt and then equity which is the order for MSEs.

2.3. Empirical Literature Review

2.3.1 Factor affecting MSEs Performance

Lack of access to financial services especially credit affected performance of the MSE sector. As a result of the problems limiting acquisition of financial services, most of MSEs continue to perform at low levels or are bound to close shop. The national survey of 1999 indicated that 36 percent of small business went down because of lack of capital (Republic of Kenya, 1999). Lending to SMEs and the limited access to formal finance due to poor and insufficient capacity by financial institutions to deliver financial services to SMEs has brought about enormous challenges to the sector (Republic of Kenya, 2004). Arguably, there is no structured institutional mechanism in Kenya to facilitate the flow of financial resources from the formal financial sector through Micro- Finance Institutions (MFIs) to the MSEs. This is in spite of the fact that nearly all mainstream banking institutions have established micro and small businesses banking. Increased transactional costs still remain a challenge. Rosenbusch *et al.* (2012) opined that acquisition of financial resources was a key challenge to entrepreneurs as they start and grow their ventures.

Bowen, Morara and Mureithi (2009) outlined some of the challenges facing small and micro enterprises as: competition, insecurity, and debt collection, lack of working capital and power interruptions. The MSEs require adequate financial services to market their products. Banks as well as other FIs are still reluctant to address this market because they are yet to get a clearer picture of the activities of prospective recipients of financial services through accurate reports of projections and results

Micro and small enterprises contribute significantly to the development and growth of economies world over. In spite of the contribution by MSEs to the economic development globally, a number of factors seem to affect their performance. MSEs had long before justified themselves by significantly contributing in raising and mobilizing new capital. Though the MSEs played a significant role in economic development, the sector continues to be faced with many challenges which are similar in most of the developing economies. The challenges that hinder the performance of MSEs are largely management oriented.

Lack of access to credit has been cited by past studies as the biggest challenge that affect performance and growth of MSEs (Munyaka, 2010 and Memba, Gakure, and Karanja, 2012). This is due to the enterprises inability to raise adequate financial resource either internally or though debt financing. Small business owners start their businesses by investing their own savings or using funds obtained from friends or relatives. Wanjohi and Mugure (2008) reported that due to lack of access to long-term credits, SMEs are forced to rely on short-term credits which are more costly. The use of short-term credits impacts negatively on the performance and growth of these firms.

In India credit was recognized at the Bangalore Exhibition as an essential input for industry and more so in the case of small scale enterprises which had weak capital base (Kulkani 1971). Mwamadzingo (1990) outlined the problems hindering the growth of MSEs as lack of credit facilities, lack of initial working capital, low demand for the products unavailability of raw materials, heavy taxes, poor record keeping and of management skills. Craig (1991) investigated credit delivery systems to the informal sector in Kenya. The study examined various institutions including commercial banks, DFIs, NBFIs and NGOs. The study examined also the schemes, which were then in operation at the time. It revealed that commercial banks, despite their countrywide outreach, capacity and well-developed network were still resistant to lend to the informal sector stating that MSEs are risky. The study further recognized the need to re-examine constraints faced by *jua kali* enterprises in order to alleviate problems of access to credit.

Kiiru (1999) observed that adequate institutional credits are not available to small businesses because the mainstream banking sector considers these businesses both risky and costly. World over, lack of access to bank credit is cited by SMEs as one of the biggest constraints (Oketch, 1999). Yet availability of credit or finance enables producers to bridge the gap between the production and sale of goods (Oketch, 1999). Credit provides business with the capacity to explore opportunities whenever and wherever they occur. For MSEs Operators', access to credit and finance of a critical moment can obviate the need to draw down inventories or capital from the enterprise to deal with immediate financial needs. Access to credit removes the pressures imposed by sudden and unexpected demands for cash on the enterprise and gives an investor some degree of freedom in deciding the most optimal timing for when and at what price to offer goods or services to the market. Financial services help people meet their business goals.

Legal and Regulatory framework is necessary in a business environment to ensure adequate controls. But the laws should not inhibit development and growth of economic entities. Malugeta (2008) outlined constraints facing SMEs as: legal and regulatory environment, lack of access to markets, finance, and business information, premises at affordable rents, skills, managerial expertise, appropriate technology and quality infrastructure. Policy-makers need to change their attitudes towards the sector to avoid conflicting policy guidelines currently present in various government departments and agencies. The sector's needs should be understood in order to create an enabling environment. Similarly, the public must be kept informed on the laws and regulations that affect the sector. Most entrepreneurs consistently encounter harassment which makes them unstable as suggested by Dodo (1999).

An enabling legal and regulatory framework is imperative for the MSE sector to play an effective role as an engine for economic growth, poverty eradication and employment creation (Republic of Kenya, 2005). Business registration and licensing is to promote growth and tax payment among enterprises. The baseline survey by Ernest and Young in 2008 revealed that most MSEs are informant, yet formalization of business promote growth and improve enterprises capability to take their responsibility to contribute to tax revenue. While the laws must not be inhibitive, the business environment requires regulation for formulization. Most financial institutions insist on registered and licensed companies to transact business. The baseline survey of 2008 (Republic of Kenya, 2008) suggested the simplification of the process of registration and licensing under the Sought Business Permit (SBP). Such simplification would ease the circumstances and make lending by commercial banks and other lending institutions simple for MSEs.

Despite the success achieved in reforming the legal and regulatory framework, most existing the laws and regulations are cumbersome and out of step with current realities and hostile to the growth of MSE sector. Gichira (1991) identified and analyzed the legal constraints that hinder the development of the informal sector. The 16 regulatory policies pointed out by the study included the trade licensing Act, The Business Names Act, The Local Government Act, The Public Health Act and The Town Planning Act. The study recommended that for the sector to realize its full potential in the economic development of the country, policies which hinder its development, were to be reviewed. Fatoki and Asah (2011) noted that for debt financing business incorporation is significant. In the Kenyan environment, legal and regulatory framework still has inappropriate laws which do not have strategies for lending to SMEs (Memba *et al*, 2012). The procedures for registration and licensing are still cumbersome yet banks require incorporation certificates and licenses for lending to small firms. Kimani (2013), legal and regulatory framework systems should be less complex to make them less costly to the entrepreneurs.

Kimani (2013) observed that large enterprises get easy access to utilities than small enterprises. This is because the large businesses have the capacity and resources to go around regulations when necessary but the MSEs cannot and therefore are seriously hampered. Large firms have more options of financing their operations including lease financing as found by Mungami (2013). Most entrepreneurs are petty traders. In the Indian experience, there has been affirmative action for protection of small enterprises for a long period

(Punyasavatsut, 2009). Affirmative action should include enactment of favourable laws on business registration and licensing as well as regulations on contracts, leasing and corporation taxes for MSEs to ease their financial burdens. MSEs consistently meet with harassment from local authorities and government officials as they attempt to operate on unused land in urban areas. Their daily license fees are often demanded several times over, since there is no definitive system for operation or supervision of informal trading. Those who operate from licensed stalls feel equally insecure as outdated by-laws are indiscriminately applied on them as was by Republic of Kenya (1999) and Mitullah (2003). Specifically, the by-laws applied by many local authorities are not standardized and appear in most cases, punitive as opposed to their ideal role of being facilitative. At the same time, the role of provincial administration tends to overlap that of local authorities over the enforcement of regulations, as well as jurisdiction over land and utilities (Republic of Kenya, 2004). The entrepreneurs in small businesses also find the judicial system complex, expensive, time consuming and sometimes unfair (Republic of Kenya, 2005). Under such situations, one would rather deal with the provincial administration and county officials than go to court.

Another factor that affects the performance of MSEs is unfavourable taxation regime. The existing tax regime is not only cumbersome but it is also a deterrent factor in the growth of SMEs. Mungami (2013) observed that in the absence of a statute specifically governing leasing, the common law that is, Income Tax Act

Cap 470 and V.A.T. Act Cap 476 combine to form the basis of the legal and tax effects of lease transactions in Kenya. This explains how the absence of specific tax regulations on MSEs could affect the transactions of small businesses. These common laws are applicable to most products and services which for small businesses would be costly to administer increasing transaction costs. In fact, the introduction of online system of making tax returns further complicates matters for MSEs.

Access to market is yet another major factor that affects performance and growth of MSEs. It requires an aggressive campaign to penetrate a market. Information about supply markets for MSEs is spotty and uneven. Thus, product quality dictated that most MSEs sell their products to low and middle- income local producers and consumers. Garikai (2011) noted that SMEs use traditional ways of marketing. The traditional marketing methods no longer appeals to customers and can be less informative. The impact created by these methods cannot generate the level of sales revenue to match the current competition. Lack of adequate market information and skills by MSEs owners/managers is perhaps due poor trining or lack of it. Kimondo, Sakwa, and Njogu (2013) argued that training on marketing of products is essential for business success. For MSEs owner/managers it is vital to take marketing training the same way as management and finance. However, due to low- income levels MSEs would find it challenging to engage in vigorous marking campaigns. This explains partly why small enterprises performance is low and sometimes failing.

Fairlie and Robb (2003) found that level of education of the business owner and business success were linked. Lack of education and entrepreneurship training are some of the constraints facing MSEs in the delivery of their services. Inadequate skills and technological innovations can be viewed by suppliers of goods and services as a weakness. Thapa (2007 noted that level of education of business owner/ manager has a positive effect on entrepreneurial success. But Thapa *et al.*, (2008) found Level of education to be remotely related business success. Business owners/managers need to regularly acquire various skills to enable them manage effectively. Though absence of education does not lead to failure, the existence of it does not necessarily lead to success of the business. Wanigasekara and Surangi (2011) noted that those with higher education level tend to be more successful with business. Chiliya and Robert-Lombard (2012) also found that there was a positive link between level of education and experience of the business owner/managers and profitability of small businesses. Kira (2013) similarly noted that firms owned and managed by less educated and less experienced had challenges accessing finance from banks. Banks and other lending institutions consider knowledge acquired through formal education and training as evidence of proficiency.

Level of education and training can be an indicator of the the range of technology that the operators can adopt and absorb. This needs to be enhanced to improve the quality of their products and competitiveness in the markets which in turn can allow them more interaction with providers of financial services. In Kenya today, and indeed all the Eastern Africa Countries (EAC), education systems have developed and there are many university graduates and graduates of middle level colleges as well as high school leavers engaged in MSEs. The graduates as suggested by (Chiliya and Robert-Lombard, 2012) can be employed in the MSEs as graduates are perceived to be skillful and are underrepresented in small businesses. Such skills were found to be relevant in the success of Chinese firms in Congo Brazzaville (Kamitewoko, 2013). For borrowing, it is not only formal education that is necessary. Even those who have better training than primary education still have difficulty accessing loans from banks and other financial institutions. And as such level of education and even technological innovations are no longer issues in the region.

Poor infrastructure has been identified as a critical factor that hinders development of business in Kenya (Republic of Kenya, 2003). The poor state of the country's road network increases the cost of producing and marketing of goods and services, thereby rendering them less competitive than imported substitutes. In addition, SMEs face a number of infrastructure problems including inaccessibility to land, workspace, feeder roads, electricity and other utilities.

Inaccessibility to land and lack of property rights hamper access to infrastructure and utilities by MSEs. Limited access to electricity is compounded by the fact that MSEs are expected to obtain an approval from local authorities before a connection can be made. Since most MSEs do not own land; it is difficult for them to get such approvals. Moreover, energy costs in Kenya are extremely high and have a negative impact on all businesses. This constraint limits MSEs technological capacity thereby adversely affecting competitiveness of their products and services (Republic of Kenya 2004). Large enterprises have enormous resource capability and therefore are able to access property for development and growth (Kimani, 2013).

Limited access to information is yet another constraint facing MSEs. The major factors in relation to information are its acquisition, capacity to interpret and effectively utilize the acquired information and dissemination of the same. In this regard, dissemination of information on legal and regulatory issues to the public and MSEs is poor, while no major efforts have been taken to sensitize key players on their roles in the formulation and implementation of policies. Without access to timely, simplified, reliable and relevant information on market opportunities, production technology and government regulations, MSEs are unable to survive and grow in the fast changing increasingly globalized and highly competitive market environment (Republic of Kenya 2004). Such information include financial information.

Demographic factors such as Gender and age of the business owner/manager are the other factors which tend to influence performance of micro and small enterprises in acquisition of financial services. Businesses need finance to be able to improve on their performance, which they can access through loans from banks and other financial institutions. Renzulli *et al.,* (2000) observed that women have fewer networks making it difficult for women to access financial services. The gender of a loan applicant is likely to affect the bank decision on loan application as gender plays a role in the credit- decision making process as loan officers evaluate male and female applications not only on the merits of the individual case, but also on their perception of men and women (Carter *el al.,* 2007). This has been imbued by gender socialization process. Decisions based on such criteria will affect performance of women owned enterprises. Performance of micro and small enterprises has been observed to be associated to access of business services and finance (Ishengoma & Kappel, 2008).

Age of the business owner/manager is another factor that that affect performance of small firms. In the a study of small grocery shops in South Africa (Chiliya and Roberts-Lombard, 2012) found that age was associated with business ownership/management with the age category of 21years and 30 years being the most prominent in owning or managing a retail firm followed by the age categories of 31years to 40 years. Jagongo (2013) found that the prime age to initiate enterprise start-up was 30 years. This is an indication that it would be easier for a business owner/manager in the age category of 21years to 45 years to perform well in a micro or small business enhancing their ability to acquire financial services.

Terms of accessing financial services vary with different institutions. Interest rate plays a significant role in the loan decision- making process by the business owner/manager. Banks and other financial institutions evaluate applicants not just on the merit of the need but also on their ability to service the cost of the facility. Aryeetey *et al.,* (2000) found that high interest rates negatively affected the ability of SMEs to pay back loans. Such positions would discourage SME owner/managers to apply for bank loans. In a study of the impact of interest rates on demand for credit and loan repayments by the poor and SMEs in Ghana (Amonoo *et al.*, 2003) found that there was a link between rates of interest and demand for credits. The study further observed that collateral security, owners' equity and annual profits are associated with demand for credit. When interest rates change the demand for credits are to change.

Operations of financial institutions are tailored to offer credit services to formally registered businesses, which meet criteria such as proper maintenance of books of accounts and a verifiable asset base. Most MSEs cannot meet these criteria. Further, availability of collateral is limited by the difficulty of obtaining title deed to land to enable them get loans. Even where collateral exists, commercial banks cannot be confident that the legal system will allow them to realize their funds in cases of default.

2.4. Summary of Literature Review and Knowledge Gap to be filled

This study aimed at investigating the determinants of acquisition of financial services by micro and small enterprises. The study was informed first, by the fact that small businesses play a very pivotal role as agents of economic development both in the developed and developing economies. Secondly, a number of studies have been done globally and even regionally and locally on performance of small and medium enterprises but none on acquisition of financial services by micro and small enterprises. The past researches concentrated on access to credits but ignored the determinants of acquisition of the financial services particularly in Kenya.

The Study by Bowen *et al.* (2009) found that there were a number of challenges faced by small and micro enterprises in Nairobi-Kenya but never showed if these challenges have effect on acquisition of financial services. Thuranira (2009) found that most of the business operators in Meru were youths with low level of education and had low startup capital since they relied on loan from family members. The study did not indicate whether or not the operators requested for loans from bank and applications rejected. Calgagnini *et al.*, (2009) concentrated on the influence of guarantee on loan pricing by focusing on the firms, producer households and consumer households. The study emphasized on the relationship between bank interest rates without indicating whether guarantee or interest rates determine acquisition of financial services.

Wanigasekara and Surangi (2010) found that level of education and business experience are positively related to business success among small retail owners/managers in Sri Lanka. Similar finding was by Chiliya and Roberts-Lombard in the study of level of education and experience on profitability of small groceries in South Africa. Islam *et al*., (2011) found that entrepreneurial and firm characteristics influenced business success of small and medium enterprises in Bangladesh. These studies did not indicate whether acquisition of financial services was determined by level of education and business experience or by firm and entrepreneurial characteristics. Jagongo (2013) concentrated on strategic savings for entrepreneurial financing for growth of women entrepreneurial ventures in Kenya. The study did not indicate whether the strategies determine acquisition of financial services by the women enterprises.

Kamitewoko (2013) showed the determinants of entrepreneurial success among the Chinese-Owned Businesses in Congo Brazzaville including level of education. The study, however, did not show the determinants of acquisition of financial services by those firms. Mungami (2013) showed how firm specific factors influenced decisions to use lease financing by firms listed at the Nairobi

Securities Exchange (NSE). The study did not indicate the determinants of acquisition of financial services by micro and small enterprises. Wehinger (2014) showed the current financing difficulties facing SMEs after the credit Crunch and policy measures but did not show the factors that determine acquisition of financial services under such situations. It is on the basis of these gaps generated by literature that this study was carried out. This study therefore, provides further information about micro and small enterprise.

2.5. Conceptual Framework

Use of credit and loans enhances the inflow of capital that is much desired by firms in the informal sector. Availability of capital will reduce constraints and as a result improve on performance. The framework shows the relationship between independent and dependant variables in the study. In this study, the dependent variable is acquisition of financial services while independent variables include; legal and regulatory framework; education and training; socio-economic and demographic factors of the firm and cost of service. Moderating factors such as government policy, competition and business environments also affect acquisition of financial services. However, these factors were not be measured since over the years Kenya Government have been enacting laws which regulates micro and small businesses such as Micro Finance Act Cap 19 of 2006 (Republic of Kenya, 2006). Furthermore there is free entry and exit into the micro and small business making completion actually a necessary evil. The relationship between dependent, moderating and independent variables is given as follows:

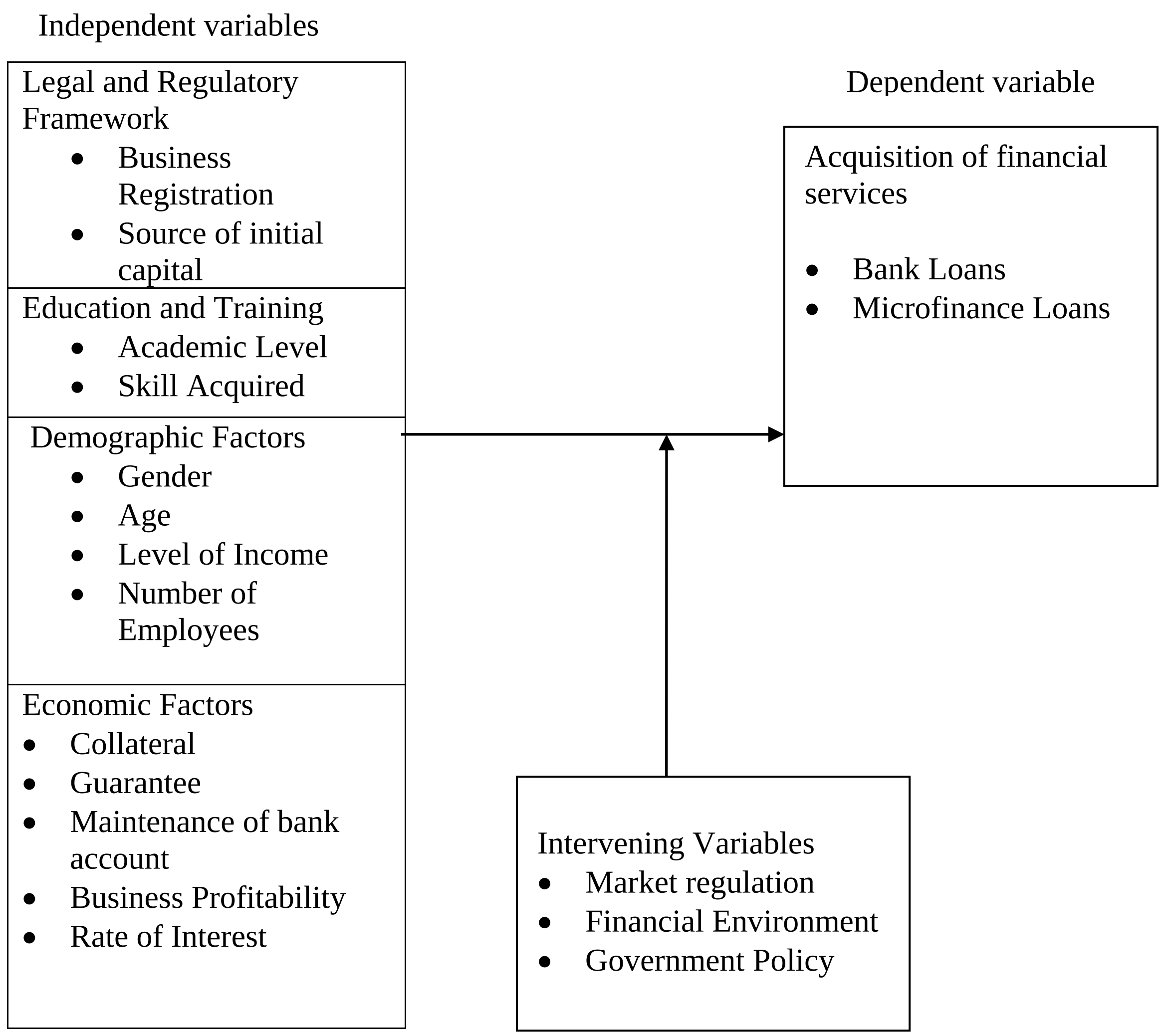

Figure 2.1: Conceptual framework

Source: Researcher (2012)

Legal and regulatory framework comprises the laws, government policies as well as the banking and lending policies. Entry into and exit from the MSE sector is free without any restrictions. The Government is responsible for legislations which regulate all business activities including business appropriateness.

Registration and licensing of businesses is a requirement for government regulation and controls. The Government is also responsible the provision of enabling business environment. Banks and other all other institutions in the business of lending formulate their policies along the government policies. These policy requirements may require that MSEs comply with certain terms for them to be able to acquire financial services. MSE owners/managers may find some of the current laws and policy requirements punitive to influence business startup and growth both of which require financial services..

Acquisition of appropriate level of education and training on the other hand enables one to obtain and use information appropriately. Business owners/managers need to be knowledgeable to negotiate effectively and make informed judgments and decisions. Lending institutions have the obligation of training the communities while the government has the obligation of providing appropriate education. Business owners/managers need to be knowledgeable to negotiate and make informed judgments and decisions. Knowledge of financial management is the single most important area of knowledge for an entrepreneur to have. But a particular level of education and entrepreneurial training could only be a necessity but not a requirement. A business owner/manager should individually identify a suitable area for training in the process of running the business.

The current trend is that demographic factors including gender, age and even level of income are factors in acquisition of financial services. This has led to categorization of institutions into small and large from inception. The categorization could be already creating attitude even before one request for a service. Lending could be better if it was on the basis of implementable innovations rather than demographic factors.

Economic factors such as rate of interest, business profitability, collateral, banking accounts and Guarantorship are perceived to influence acquisition of financial services. All lenders give credits for a gain. As a result, they charge interest. Businesses should borrow at all times based on need. Banks and other lending institutions consider even more factors in addition to interest. Business owners/managers could be in distress as a result of poor business environment but the banks are asking profitability statement, collateral and guarantee. A business in such a state of distress is unlikely to have adequate collateral and even guarantee and most likely will not be considered for a financial service.

All these factors do not operate in isolation. The factors themselves are inter-related. There are also other factors which their effects are not direct but intervene in the overall result. Market factors of demand and supply would definitely define the direction of the flow of financial services. Financial environment is critical capital flight. Situations like the global melt-down may force lending institutions to re-define their lending policies. Government policies also have effect on financial activities as new policies are formulated from time to time. All these factors may affect lending cost generally and particularly to micro and small enterprises.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter covers the description of the research design, model specification, population of the study, sample size and sampling technique, data collection instruments, data collection procedure, data analysis and expected output.

3.2 Research Philosophy

The research philosophy adopted by this study was positivism approach. Positivism philosophy is appropriate when a study is based on observable social reality (Cohen and Crabtree, 2006). Saunders *et al.*, (2009) stated that positivism philosophy is adopted when working with observable social reality and that the end product of the research can be generalized in the form of law. This study was based on observable social reality. It was based on hypotheses that were tested and thus were not rejected or rejected.

3.3 Research Design

The design adopted by the study was descriptive survey design. Descriptive survey design allows the formulation of a problem for more precise investigation (Wilkinson and Bhandarkar, 1986; Kothari, 2006). The use of descriptive design was appropriate for such a study since the design provided for identification of general patterns as indicated by (Saunders *et al*, 2009). Consequently, the study explained the extent to which both internal and external factors affected the acquisition of financial services by micro and small enterprises in Kenya. Further the design was appropriate for this study as it provided an in-built flexibility that would transform the research problem to one with more precise meaning.

3.4 The Model Specification

In this study, it was assumed that a firm is faced with two options; either to acquire financial services from formal financial institutions or the other alternatives. The general model to explain the choice is a binary choice model involving estimation of the probability of acquiring financial services as a function of a vector of explanatory variables. Assuming Y to represent MSEs decision to acquire financial services, Y_i = 1, otherwise Y_i =0. It was taken also that the probability to acquire financial services has a relationship with the observable external and internal characters of, regulatory framework, cost and other institutional operating environment characteristics. If the probability of acquiring financial services was given as;

$$P(Y=1) = F(X, \beta) \quad (3.1)$$

Then the probability of not acquiring financial services to be represented as:

$$P(Y=0) = 1 - F(X, \beta) \quad (3.2)$$

Where;

P (.) being the probability that a given decision is taken, Y is observed response, so that for the ith item Y_i = 1 if financial services are acquired and Y_i = 0 if otherwise

X is a vector of explanatory variables that affect the probability of acquiring the financial services.

β is a vector of the co-efficient of explanatory variable that describes how changes in the variables influence probability of acquiring financial services. The general function F (.) took the form of a linear, logistics or multiplicative function. The one that gave a statistically sound model was adopted and interpreted. Multinomial logit model was preferred in estimation of probabilities as it overcame linearity problems and provided parameter estimates that were efficient and consistent.

The study used a logistic cumulative distribution function and estimated the probabilities as follows:

Taking P(Y = i), i = 1, 2, 3…….n, where i represents the various firms acquiring financial services, and e is a natural number.

$$P\left(y=1\right)=\left[\frac{\ell^{x\beta_1+\mu}}{1+\sum_{i=1}^{4}e^{X\beta i+\mu}}\right] \quad \text{………………………………………………………… (3.3)}$$

$$P\ (y=2)=\left[\frac{\ell^{x\beta_1+\mu}}{1+\sum_{i=1}^{4}e^{X\beta i+\mu}}\right] \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(3.4)}$$

$$P\ (y=3)=\left[\frac{\ell^{x\beta_3+\mu}}{1+\sum_{i=1}^{4}e^{X\beta i+\mu}}\right] \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(3.5)}$$

$$P\ ((y=4)=\left[\frac{\ell^{x\beta_4+\mu}}{1+\sum_{i=1}^{4}e^{X\beta i+\mu}}\right] \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(3.6)}$$

Taking P(y = 1) as the base group the equation is given as,

$$\left[\frac{p_r(y=i)}{p_r(y=1)}\right]=e^{X(\beta_i-\beta_1)+\mu}\ \text{, (i = 2, 3, 4)}\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(3.7)}$$

Taking natural logarithms from both sides and letting own saving be the base gives;

$$\text{In}\ \left[\frac{p_r(y=i)}{p_r(y=1)}\right]=X(\beta_i-\beta_1)+\mu\ \text{, (i = 2, 3, 4)}\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(3.8)}$$

The equation can be rewritten as;

$$\ln\left[\frac{p_r(y=i)}{p_r(y=1)}\right]=\alpha_0+\alpha_1\,\text{Gen}+\alpha_2\,\text{Ag}+\alpha_3\,\text{Ed}+\alpha_4\,\text{Tr}+\alpha_5\,\text{Ca}+\alpha_6\,\text{In}+\alpha_7\,\text{Size}+\alpha_9\,\text{Leg}+\alpha_{10}\,\text{ac}$$

$$\text{c}+\alpha_{11}\text{Cos}+\alpha_{12}\text{Col}+\alpha_{13}\text{Garr}\,\alpha_{14}\text{Pro}+€\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots \text{(3.9)}$$

Where $\alpha_i=(\beta_{ji}-\beta_{j1})$

1n =Natural logarithms to base e

α_0 = a constant

Gen= Gender (Sex of the owner/manager)

Age= Age of respondent

Ed= Level of education

TR = Training

Cap = Level of capital

Inc = Level of income

Siz = Number of employees

Leg = Registration of business

Acc = Maintenance of bank Account

Garr = Guarantee

Pro = Profitability

Cos. = Rate of Interest

Col = Collateral

ε = error term of the model

The variables were categorized, defined and measured as indicated by table 3.1.

Table 3.1: Variable Definition and Measurement

Variable	Type	Type of scale	Measurement
Collateral	Independent	Nominal	Value of assets in shillings
Age	Independent	Ordinal	Years
Education	Independent	Ordinal	Level of education (classified in 4 categories)
Gender	Independent	Nominal	Category
Guarantee	Independent	Nominal	Category
Training	Independent	Nominal	Level Obtained (classified in two categories)
Profitability	Independent	Interval	Level
Rate of Interest	Independent	Ratio	Percentage
Firm Size	Independent	Ordinal	Category
Capital	Independent	Ratio	Amount in shillings
Security	Independent	Nominal	Level(Classified in two categories)
Level of business Income	Independent	Ratio	Annual Revenue in shillings
Maintenance of account	Independent	Binary	Yes/No
Maintenance of Insurance	Independent	Binary	Yes/No
Source of initial capital	Independent	Ordinal	Category
Registration of business	Independent	Binary	Yes/No
Acquisition of Financial services	Dependent	Binary	Yes/No

3.5 Location of the Study

The study was conducted in Langata Sub-county of Nairobi County. Langata is one of the eight sub-counties that make Nairobi County. Many Kenyans, particularly, the youths who come to Nairobi in search of employment end up with micro and small businesses due to lack of employment or underemployment.

Langata provides various types of businesses making it an ideal location for a study of this nature and magnitude.

World-wide, the significance of MSEs in economic growth is underscored by their contribution in both the developed and developing economies. In spite of their role in economic development, MSEs are still faced with several challenges in their working conditions. Both internal and external factors such as legal requirements, finance, and management, social and economic, demographic, education and training, and cost of services still pose challenges to the contribution of MSEs to the development process. The profile of MSEs in Langata Sub County was generated on gender and ages of the respondents, educational level, professional training of owners/managers, and value of capital, level of income, ownership structures, legal requirements, employment levels and business security.

3.6 Target Population

The target population for this study was 2,098 micro and small firms. The population was organized on the basis of sectors. The following table 3.2 shows the population per sector.

Table 3.2: Population by Sector

SECTOR		POPULATION
1	Retailers	1215
2	Manufacturers	31
3	Distributors	37
4	Caterers	195
5	Motor vehicle repairs/services	117
6	Import/Export services	1
7	Commission Agents	419
8	Wholesalers	1
9	Educational Institution	58
10	Other (Agric. Product processing mining and natural resources, health, communication and entertainment facilities).	25
	Total	**2,098**

Source: NCC, 2009

The population comprised 1,215 retail outlets, 31 manufacturing, 37 distributors, 195 caterers, 117 motor vehicle repairers, 1 export and import firm, 419 commission agents, 1 wholesaler, 58 educational institutions and 25 agricultural and processing firms operating in Langata within Nairobi, County. The licensing department of Nairobi City County (NCC) provided evidence of the existing firms.

3.7 Sampling Technique and Sample Size

Stratified random sampling technique was used to obtain 250 firms. The unit of analysis was the MSE firms while observations were on the owner/managers. Strata was based on sector with a wide range of economic sectors including: retail outlets, manufacturers, distributors, caterers, motor vehicle repairs, import and export services, commission agents, wholesalers, educational institutions and others. Table 3.2 shows the sample by sector.

Table 3.3. Sample Size by sector

Code	**Sector**	**p**	**n**
1	Retailers	1215	145
2	Manufacturers	31	3
3	Distributors	37	5
4	Caterers	195	22
5	Motor Vehicle Repairers	117	14
6	Import and Export	1	1
7	Commission Agents	419	50
8	Wholesalers	1	0
9	Educational Institutions	58	7
10	Other (Agric. Product processing mining and natural resources, health, communication and entertainment facilities).	25	3
	Total	2098	250

Source: NCC, 2009)

Adopting proportional allocation, the sample size for each stratum was obtained as follows:

$$n = \frac{P_i}{N}(s)$$

Where n= total sample size of each stratum

P_i = the proportion of the population included in the ith stratum

N = total population

For each sector, random numbers were generated using computer random number generator. Lists were generated according to random numbers and required numbers obtained. The sample of 250 firms was drawn from the target population of 2,098 firms. Stratification by sector of the firms was used to arrive at the sample size of 250 micro and small firms. Table 3.2 provides the sectorial distribution of the samples. Given the size of the population, a sample of 250 firms was considered to be adequate. An optimum sample is one that fulfils the requirements of efficiency, representetiveness, reliability and flexibility (Kothari, 2006). By the rule of the thumb, a sample size of 30 or more will usually result in a sampling distribution for mean that is very close to a normal distribution (Saunders *et. al.*, 2009).

3.8 Research Instruments

The study used primary data which was collected by semi-structured questionnaires. The questionnaire compromised straight forward and easy to comprehend questions which enabled respondents to take a short time to complete. Semi-structured questionnaires are usually in an immediate usable form and are easy to analyze and interpret (Kothari, 2006). The questionnaire was made up of both open and closed ended questions as provided at Appendix I.

3.9 Reliability

The questionnaire was developed with the help from senior members of academic staff prior to using the instrument to collect data. The comments and suggestions from the experts were incorporated as suggested by Saunders *et al.* (2009). A reliable result is possible to obtain only when the instrument for data collection is itself reliable. Reliability is one of the important elements of test of quality as it ensures internal consistency or stability of the test over time. Thus the same instrument should be able to generate similar results if applied at a different time but same conditions and method.

3.10 Validity

Validity is the test of quality of research with similar importance. For study results to be valid, the instrument used should measure what it was set to measure. Data for this study was collected using questionnaires which required detailed pre-test for validity before use. The instrument was tested to ensure, first and foremost the content validity. Research results can only be said to be valid when data collected were correctly and accurately measured.

3.11 Pilot Study

Saunders *et al.,* (2009) noted that prior to administering a questionnaire to collect data it should be pilot tested to refine the questions. The pilot testing assists to avoid problems of answering questions by respondents, recording data as well as establishing content validity. For this study, 10 items were used for piloting which is the minimum number allowed for studies with small population. Reliability is expressed in the form of correlation coefficient with values ranging from 0.00 representing low reliability to 1.00 representing perfect reliability. Adopting the Cronbach's alpha the pilot result showed a value of 0.713 which was considered adequate. A minimum alpha value of 0.6 is considered acceptable in research while a value of ≥ 0.9 is considered excellent (Cronbach, 1994). Using SPSS the computed Cronbach alpha for all the variables of this study was 0.839 which is much higher than the pilot result of 0.713. This implied that the findings of the study were reliable and valid.

3.12 Data Collection Procedure

The researcher obtained a letter of introduction from Kenyatta University and research permit from National Council for Science and Technology of Ministry of Higher Education, Science and Technology to allay any suspicion and elicit serious responses thus increasing validity of the results. First, the locations of the firms selected for observation were identified. The respondents were briefed on the purpose and importance of the study. As agreed at the briefing session the questionnaires were dropped at the locations and later picked at the time agreed between the researcher and respondents. To enable the respondents to take the least possible time, questions were framed in a straight forward and easy to comprehend way.

3.13 Data Analysis

Data for this study were both qualitative and quantitative. Qualitative Data was analyzed using descriptive statistics and presented using percentages and frequency distribution. Inferential statistics including Chi-square tests, correlation and logit regression model were used to analyze quantitative data. Application of inferential statistics was to enable the researcher estimate population on parameters and, test the hypotheses for the purpose of generalization of the findings (Kothari, 2006). Chi-square was used to test the independence of the variables. Spearman correlation coefficient was used for objective three to measure the strength and direction of association that existed between the independent variables and the dependent variable. Multinomial Logistic Regression model indicated in the model specification was applied.

The data analysis techniques used are summarized in table 3.3.

Table 3.4 Data Analysis Techniques

Objectives	Variables	Descriptive statistics	Inferential
Legal and Regulatory Framework	• Business registration • Source of initial capital • Maintenance of bank a/c • Insurance	- Frequencies	▪ Chi-square ▪ Multinomial regression
Education and Training	• Education • Entrepreneurial training	- Frequencies	▪ Chi-square ▪ Multinomial regression
Demographic Factors	• Gender • Business income • Number of employees • Age of respondents	- Descriptions - Frequencies - Graphs	▪ Chi-square ▪ Multinomial regression ▪ Spearman's correlation
Economic Factors	• Need for bank a/c • Guarantee • Collateral • Profitability • Rate of interest	- Frequencies	▪ Chi-square ▪ Multinomial regression

* P-Value measured at 0.05

The screening for dependence of the variables and testing of the hypothesis is presented in chapter four.

CHAPTER FOUR

EMPERICAL RESULTS, INTERPRETATION AND DISCUSSIONS

4.1 Introduction

The previous chapter presented the methodology that was used in the study. This chapter presents data analysis, empirical results, interpretation and discussions. The chapter starts with response rate followed by the effects of legal and regulatory framework, relationship between education and training, relationship between the number of employees and effects economic factors on acquisition of financial services. This chapter has been organized on the basis of research objectives, research questions and study hypotheses.

4.2 Response rate

The number of questionnaires sent to the respondents was for the entire sample size of 250. Table 4.1 below indicates the response rate based on the sizes of the firms.

Table 4.1 Response rate in terms of firm sizes

Firm size	frequency	**%**
Micro	192	83.1
Small	39	16.9
Total	**231**	**100**

Source Researcher 2012

From the 250 questionnaires sent out, a total 231 were returned. This translated to a response rate was 92.4 percent. The high rate of response was attributed to the personal involvement of the researcher and the tremendous efforts by the research assistants. Response rate is an important component of a study. It gives an indication of the quality of research findings as well the level of reliability that could be placed on the results. Whereas some previous studies indicated that high response rate yielded accurate results, others are not in agreement. A study by (Rear and Parker, 1997) indicated that higher response rates assured more accurate survey results. The findings by Rear and Parker (1997) contradicted an earlier finding by Visse *et al.,* (1996) which showed that even surveys with lower response rates yielded more accurate results

For a study of this magnitude a response rate of 92.4 percent was considered very well. Mugenda and Mugenda (2003) observed that a response rate of 50 percent is adequate, 60 percent is good with 70 percent being rated as very good. Holbrook *et al.* (2005) assessed the effects of lower response rates and found that surveys with much lower response rates were only minimally less accurate although a lower response rate may lead to a non-response bias. The contradiction shows that response rates are only informative and do not necessarily differentiate between accurate and inaccurate data. For this study, there was need for high response rate given that MSEs are very many and are diverse in their nature of operation Majority of the firms, 79.7 percent (n=184) were micro while 14.7

percent were small. A small proportion of 2.2 percent were outside the sampled firm sizes while 3.5 percent did not indicate their firm sizes. According to the Nairobi County Licensing Department (NCLD) (2009), the size of business is defined by the amount of the licensing fee. This study, used number of employees to determine firm sizes. That explains the difference in the numbers of micro and small enterprises as given in the sample frame.

4.3. Legal and Regulatory Framework and Acquisition of Financial Services

The first objective of the study was to determine the relationship between legal and regulatory framework and acquisition of financial services. The results are presented using descriptive statistics, chi-square tests and multinomial logistic regression. The influence of legal and regulatory framework on acquisition of financial services was analysed with respect to business registration, source of initial capital, maintenance of bank accounts and maintenance of insurance for the business.

4.3.1 Business Registration

Business registration with government legal or trade departments is a requirement in all countries. Except for Savings and Corporative Credit Societies (SACCOs), most financial institutions in Kenya including Micro Financial Institutions (MFIs) require some form registration. In Kenya for example, businesses are required to register under the Business names Act Cap 599 and Companies Act Cap 468 the laws of Kenya. . Lenders of money, including banks and micro-finance institutions view registration of business as a form of security for the services they provide in case of default. Table 4.2 provides the distribution of MSEs regarding this legal requirement. Furthermore, business entities are required to be licensed by the Government licensing department or any other authorized government agencies in order to operate.

Table 4.2: **Business registration**

Registration	frequency	%
Registered	81	35.1
Not registered	124	53.7
None committal	26	11.3
Total	231	100

Source: Researcher (2012)

Out of the 231 respondents only 35.1 percent (n=81) indicated they were registered with the registrar of companies, 53.7 percent (n=124) were not registered while 11.3 percent (n=26) did not indicate their registration status. This leads to non-recognition by other business entities and can explain why a large number of these businesses remain small with individuals as the main customers and not corporate customers. To test the relationship with acquisition of financial services, respondents were asked to indicate whether business registration influenced their loan application or not. The test of association was done by carrying out chi-test. Table 4.3 shows the results.

Table 4.3: **Relationship between Business registration and loan application**

Registration status		Have you ever applied for a bank loan again		
		Yes	No	Total
Registered	F	12	20	32
	%	37.5	62.5	100%
Not registered	F	17	33	50
	%	34.0	66.0	100%
Chi-value	0.105			
P-value	0.815			

* P-Value measured at 0.05

The result showed that 62.5 percent of the firms not registered did not apply for loans. This was an indication that most of the small enterprises do not seek business incorporation or obtain trading licenses. The chi-square result was; $\chi^2 = 0.105$, $P = 0.815$. The result indicated that business registration had no association with acquisition of financial services. The study hypothesis was that there is no relationship between business registration and acquisition of financial services. Since the chi-square result indicated a p-value > 0.05, the hypothesis was not rejected. Table 4.3 provides the chi-square results for the status of business registration and its relationship with acquisition of financial services at the initial stage and subsequent loan application. Previous studies indicated that there is relationship between business registration and debt-financing. Banks consider business registration as a good sign of firm credibility (Cassar, 2004). The finding is therefore consistent with the finding of Fatoki and Assah (2011) that business incorporation positively impacts on access to credit.

4.3.2 Source of Initial Capital

Capital is a fundamental factor in the life of an enterprise. The value of capital that a business holds actually defines the direction and growth pattern of the enterprise. Businesses require financial capital in order to startup, grow as well as sustain their operations. Source and value of capital for a business is dependent on the ability of the owner/manager to mobilize the funds. The value of Startup capital is the initial indicator of the ability of businesses to sustain its planned levels of activities In this study, capital is discussed in terms of source and value. Table 4.4 shows the various sources of capital used by the entrepreneurs to obtain their initial capital.

Table 4.4 Respondents sources of initial capital

Sources of initial capital	frequency	%
Own saving	162	70.1
Bank loan	28	12.1
Loan from friends	13	5.6
Loan from credit associations	4	1.7
Others	24	10.4
Total	**231**	**100**

Source: Researcher 2012

The result showed that majority of the respondents 70.1 percent (n=162) indicated they used their own savings. 12.1 percent (n=28) obtained loan from bank and other financial institutions, 5.6 percent (n=13) received loan from friends, while 1.7 percent (n=4) were loaned by credit associations and 10.4 percent (n= 24) did not indicate their source of capital. Startup capital is a critical variable as an indicator of ability to sustain a planned level of activities.

The study hypothesized that there was no relationship between source of initial capital and acquisition of financial services. Table 4.5 shows the relationship between source of initial capital and acquisition of financial services.

Table 4.5: Relationship between source of initial capital and acquisition of financial services

Loan application		Source of initial capital				
		Own savings	**Loan from bank**	**Loan from friends**	**From credit associations**	**Total**
Yes	F	13	16	0	0	29
	%	44.8	55.2	0.00	0.00	100%
No	F	41	9	1	1	52
	%	78.8	17.3	1.9	1.9	100%
Chi-value	12.995					
P-value	0.005					

Source: Researcher (2012)

* P-Value measured at 0.05

The chi-square was 12.995 with a p-value of 0.005. Based on the result it is observed that majority of the firms, 52.2 percent which applied for subsequent loans had used bank loan as the source of initial capital while 44.8 percent (n=13) of the respondents who had applied for the subsequent loan had used own savings as initial capital. Majority, 78.8% (n=41) of the firms which used their own savings as initial capital did not apply for loan compared to 17.3% (n=9) of those who started with loan from bank and did not apply for another loan. The following table 4.6 shows the value of startup capital used by different firms.

Table 4.6: **Startup capital used by the respondents**

Startup capital	frequency	%
Below 10000	34	14.7
10,001 – 20,000	45	19.5
20,001 – 30,000	29	12.6
Above 30,000	93	40.3
None committal	30	13.0
Total	**231**	**100**

Source: Researcher 2012

On the basis of table 4.6 it is notable that majority of the respondents used less than sh.30, 000 as startup capital. The respondents who used more than sh.30, 000 were 40.3 percent (n= 93). This was an indication of a weak financial capital base for most of the MSEs. A study by Fairlie and Alicia (2003) on why black –owned businesses were less successful indicated that less successful businesses were associated with lower levels of startup capital. In the absence of external sources which are small business oriented such as venture capital, MSEs resorted to internal financing particularly own savings. Bessant, Laming, Noke, and Phillips (2005) noted that in Europe for example, lack of venture capital has been a particular barrier to small firms. Because of the weak financial base, the businesses are likely to face liquidity problems. As observed by Peng and Bewley (2010), financial capital is a key part of the resource base of any firm. Lack of financial capital may lead to liquidity constraints. Liquidity constraints do limit the survival of small firms (Fairlie and Robb, 2007a and Saridakis, Mole, and

Storey, 2008). The financial risk involved in the investment decision has a decisive influence on the rate and direction of the firm's growth.

To determine the direction of the relationship between start up capital and value of assets held by a firm, correlation analysis was undertaken. Table 4.7 shows the result of the relationship between level of startup capital and current assets.

Table 4.7: **Startup capital and the current assets of the business**

	Assets (Ksh.)				
Startup capital (Ksh.)	**Below 50,000**	**51,000-100,000**	**101,000-200,000**	**Above 201,000**	**Total**
Below 10,000	18(56.3%)	11 (34.4%)	1 (3.1%)	2 (6.3%)	32(100%)
10,001- 20,000	11 (26.8%)	16 (39.0%)	10 (24.4%)	4 (9.8%)	41(100%)
20,001 -30,000	2 (8.0%)	12 (48.0%)	6 (24.0%)	5 (20.0%)	25(100%)
Above 30,000	4 (4.9%)	11 (13.4%)	28 (34.1%)	39 (47.6%)	82 (100%)

r ==0.205

P=0.005

Source: Researcher 2012
*P-value at 0.05

The finding indicated that correlation coefficient was 0.205 while p-value was 0.005 indicating a relationship between startup capital and asset value. Table 4.7 shows the result. The asset value is an indicator of the growth pattern of a firm. The asset value of majority of the firms, 56.3 percent (n =18) of the firms whose startup capital were below sh.10, 000 have not grown above sh.50, 000. 34.4 percent (n =11) fell between sh.51, 000 and sh. 100,000, 3.1 percent (n =1) reached sh.200.000 while only 6.3 percent (n=2) increased beyond sh. 200,000. Firms whose startup capital were in excess of sh. 30,000 were 4.9 percent (n=4) with asset value of less than sh. 10,000 while 47.6 percent (n=39) of the firms with capital in excess of sh.30, 000 had grown beyond the amount of sh. 200,000.

Current business asset value of the businesses was related ($r = 0.205$, $P = 0.005$) to the amount of startup capital of the businesses. Businesses that had startup capital of below Ksh.10,000 currently reported asset value of below Ksh.50,000 while those business which had higher amount above Ksh.30,000 had asset value of above Ksh.201,000 The result reveal a trend on how startup capital influenced current asset value after startup. Blanchflower and Oswold (1998); and Dunn and Douglas (2000), indicated that asset levels play an important role in determining who enters into or exits from self-employment. Entrepreneurs in Kenya are self-employed and struggling to stay in the employment. The study also sought to determine the relationship between source of initial capital and subsequent acquisition of financial services.

4.3.3 Maintenance of Insurance

Banks and financial institutions require some form of assurance against the risk of default by borrowers as a result of business failure. Level of insecurity could also expose businesses to kind of financial risk for fear of attacks or extortions that could force a business to close down or to relocate. Micro and Small Enterprises face several security challenges ranging from outright crimes as well as frequent interference by county authorities and other government agents. The respondents were asked about their views on the security situations. Table 4.8 shows how the firm managers/owners viewed security to their businesses.

Table 4.8: Respondents rating of the security of their business

Rating	frequency	percent
Very secure	26	11.3
Secure	138	59.7
Not secure	28	12.1
Non-committal	39	16.9
Total	231	100

Source: Researcher 2012

Although majority of respondents 59.7 percent had indicated that their businesses are secure, insecurity still poses a big challenge to businesses as indicated by Bowen (2009). When governments fail to provide protection to residents and their assets, business owners and managers turn to other forms of security or migrate to other business locations. In Mexico for example, a study by Foundation MEPI de periodismo de Investigacion and journalism students from the Tecnologico de Monterry, Campus Ciudad de Mexico in 2011, found that due to crime and violence there was migration to the interior from 2005. In Kenya, insecurity is one of the top three challenges to business (Bowen *et al*, 2009). Many enterprises hire private security firms or guards to protect them and their assets which increase their operational costs. Micro and Small Enterprises faced with such challenges might need to acquire insurance policies to cushion their business against losses due to insecurity in addition to guaranty and collateral. Consequently, respondents were asked to indicate whether or not they maintained insurance for their businesses. Table 4.9 presents the results.

Table 4.9: Maintenance of insurance and acquisition of financial services

		Maintenance of insurance		
Loan application		**Yes**	**No**	**Total**
Yes	F	16	12	28
	%	57.1	42.9	100%
No	F	17	35	53
	%	32.7	67.3	100%
χ^2	4.490			
P	0.034			

* P-Value measured at 0.05

The result indicated that 57.1% (n=16) of those who maintained insurance, applied for loan compared to 32.7% who had insurance but did not apply. For those who did not maintain insurance only 42.9% (n=12) applied for bank loans while 67.3% (n=35) never applied. The chi-square result was; χ^2 = 4,490, P = 0.034. The result indicated existence of relationship between maintenance of insurance and acquisition of financial services since the p-value was < 0.05. The hypothesis that there was no relationship between maintenance of insurance and acquisition of financial services was therefore rejected.

4.3.4 Regression Results for Legal and Regulatory Factors

The study tested the hypothesis that legal and regulatory factors of business registration, source of initial capital, maintenance of bank accounts and maintenance of insurance for the business do not influence acquisition of financial services. Based on the results of the bivariate analysis, source of initial capital and maintenance of insurance were found to be related to acquisition of financial services. Multinomial Logistic regression analysis was carried out to test for the strength of the relationship between legal and regulatory factors on acquisition of financial services by MSEs. Table 4.10 provides the findings.

Table 4.10; Relationship between Legal and Regulatory Factors and Acquisition of Financial Services

Predictor variables	B	Std. Error	Wald	Sig.	Exp(B)	95% Confidence Interval for Exp(B)	
						Lower Bound	Upper bound
Source of initial capital	16.889*	0.538	985.087	0.000	21626467.3	75324489.5	62091568.8
Maintenance of insurance	0.767	0.518	2.191	0.139	2.153	0.780	5.947

Source: Researcher 2012.

* Indicate that the coefficient is significant at 5% level.

The findings, indicated that the model fit for the two variables was significant at 95 percent level of confidence (The R-squared was 0.223). This implied that the source of initial capital explained 22.3 percent of the variation in the acquisition of financial services. The result indicated that source of initial capital had significant positive relationship with acquisition of financial services at 95 percent level of confidence. The coefficient (β) was 16.889 with a p=0.001 that is less than 0.05 implied that the co-efficient was statistically significant. Therefore, source of initial capital explains the acquisition of financial services. However, the coefficient of the maintenance of insurance was 0.767 with a p=0.139 that is >0.05. This indicated that maintenance of insurance did not influence acquisition of financial services by micro and small enterprises. The result implied that the overall result on maintenance of insurance was influenced mainly by source of initial capital. Wald's chi-square results were positive, indicating a positive relationship between legal and regulatory framework and acquisition of financial services. The hypothesis was therefore not accepted.

The finding on the relationship between source of initial capital and acquisition of financial services showed that majority of businesses are still financed through own savings. Furthermore, the businesses which started with loan from financial institutions as initial capital are likely to access subsequent financial services more than the businesses that used own savings and capital from other sources. The pattern, however, is not likely to remain the same forever due to changes in the banking and finance policies. This condition might have prevailed as a result of lack of information on the part of entrepreneurs. The finding is in support of the study by Thapa *et al.* (2008) who noted that there was a positive relationship between initial source and value of capital and entrepreneurial success

4.4 Relationship between Education and Training and Acquisition of Financial Services

Education and entrepreneurial training are key factors of production and agents of growth of an economy. It is largely perceived that the two factors have influence on decision- making that is associated with the acquisition of financial services. The second objective of this study was to determine the relationship between level of education and the entrepreneurial training attained by the business owner/ manager and acquisition of financial services by micro and small enterprises. The business owner/managers were asked to indicate the level of education they attained and their entrepreneurial training.

4.4.1 Level of Education attained by Business Owner/Managers

Table 4.11 presents the result of the distribution of level of education of business owners/managers.

Table 4.11 Education level of the respondents

Education Level	frequency	%
Primary	8	3.5
Secondary	50	21.6
College	108	46.8
University	60	26.0
Non- committal	5	2.2
Total	**231**	**100**

Source: Researcher 2012

Majority of the respondents 46.8 percent (n=108) were college graduates and 26 percent (n=60) are university graduates with only 3.5 percent being primary education and 21.6 percent secondary school graduates as indicated by table 4.11. This is an indication of a well-educated work force particularly in the urban set ups. In terms of gender, the distribution of the level of education of the entrepreneurs is given by table 4.12.

Table: 4.12 Entrepreneurs Level of Education based on Gender

	Entrepreneurs level of education				
Gender	**Primary**	**Secondary**	**College**	**University**	**Total**
Males	6 (4.3%)	20(14.2%)	71(50.4)	44(31.2%)	141(100%)
Female	2(2.4%)	30(35.3%)	37(43.5%)	16(18.8%)	16 (100%)

Researcher, (2012)

As indicated by table 4.12, 31.2 percent (n=44) male respondents had university education while 50.4 percent (n =71) had college education compared to only 18.8 percent of the females with university education and 43.5 percent of the females having College education.

To determine the relationship between level of education and acquisition of financial services, respondents were asked to indicate if they had applied for financial services from financial institutions after their initial capital. Table 4.13 shows the distribution of the firms which had applied and those which had not applied.

Table 4.13 Level of Education and Acquisition of Financial Services

Education levels	Application for financial services after start up: Applied for loan	Application for financial services after start up: Did not apply for loan	Total
Primary	0 (0%)	1 (100%)	1 (100%)
Secondary	4 (28.6%)	10 (71.4%)	14 (100%)
College	13 (33.3%)	26 (66.7%)	39 (100%)
University	12 (41.4%)	17 (58.6%)	29 (100%)
Total	29 (34.9%)	54(65.1%)	83 (100%)
χ^2 = 1.360			
P = 0.715			

Source: Researcher (2012)

The results indicated that none of the owner/managers with primary education had applied for financial services. Only 28.6 percent (n=4) of those with secondary education had applied while 71.4 percent (n=10) had not applied. For owner/managers with college education, 33.3 percent (n=13) had applied but 66.7 percent (n=26) did not apply. Firm owner/managers with university qualification had the highest number of applicants for financial services with 41.4 percent (n=12) and those who did not apply being 58.6 percent (n=17). It can be observed that the number of owner/managers applying for financial services increases with the level of education.

The chi-square results indicated that the level of education and application for financial services were independent (χ^2 = 1.360, P = 0.715). Since the p-value was > 0.05 it implied that the hypothesis that there was no relationship between level of education and acquisition of financial services should not be rejected. Based on the result it is noted that any business owner/manager could apply for and acquire financial services from any financial institution.

The overall belief in business is that entrepreneurial success is only possible with a strong financial base which is built around both internally and externally acquired financial services. Level of education has been considered to be an important basis of entrepreneurial success. Barro (1991) had observed that education plays a very important role in economic growth.

The finding of this study supports the finding of (Thapa *et al.,* 2008) that level of education had only a moderate positive relationship with the success of the business. And the finding fits well with Kenya since Kenya has a vast pool of well-educated population which needs no classification for success of business. The trend is likely to continue given that Kenya has continued to improve on the education system and education policies. Kenya under the Vision 2030, aimed at expanding access to education, improve transition rate from primary to secondary and raise the quality and relevance of education (Republic of Kenya, 2007).

Fairlie and Robb (2003) found that success of business was linked with level of education of the owner. Wozniak (2006) also found that business owner/managers need education to be able to acquire and use information appropriately. Thapa

(2007) had observed that level of education had a positive effect on entrepreneurial success. Doms *et al.*, (2010) had indicated that the level of education of entrepreneurs is strongly related to positive outcomes especially for college graduates compared to those with less than a four year degree. Wanigasekara and Surangi (2010) further agreed that owner/ managers with higher education experience better results. They compared owner/managers with formal education of up to Advance Level (AL) with those of up to Ordinary Level (OL). Those with higher level of education have been deemed to have better access and use of information, particularly financial information. Profit is considered as a fundamental indicator of growth and success of a business. And profit planning needs at least some level of education. However, none of these studies indicated whether or not level of education influenced acquisition of financial services.

The study tested also for any relationship between level of education of owner/managers and start up capital. Table 4.14 presents the results.

Table 4.14: **Level of Education and startup capital**

	Startup capital				
Education levels	**Below 10,000**	**10,001 – 20,000**	**20,001-30,000**	**Above 30,000**	**Total**
Primary	7 (87.5%)	1(12.5%)	0 (0%)	0(0%)	8 (100%)
Secondary	8 (18.6%)	14 (32.6%)	4 (9.3%)	17(39.5%)	43 (100%)
College	7 (7.4%)	22 (23.4%)	18 (19.1%)	47 (50%)	94 (100%)
University	10 (18.9%)	7 (13.2%)	7 (13.2%)	29 (54.7%)	60 (100%)
Total	32 (16.2%)	44(22.2%)	29 (14.6%)	93 (47.0%)	198(100%)
χ^2 42.933					
P-Value 0.001					

Source: Researcher 2012.

Majority of the respondents, 87.5 percent with primary education had startup capital of up to sh. 10,000 only. Majority of those with secondary education, 39.5 percent started with more than sh.30, 000 while 50 percent of those with college education started with more than sh. 30,000. 54.7 percent of those with university education started with capital of more than sh. 30,000. This was an indication of a dependence between level of education and value of capital used (χ^2 = 42.923, P = 0.001). Based on this finding, it can be concluded that with a higher level of education one was able to access high values of capital.

4.4.2 Entrepreneurial Training of Business owners/managers

Entrepreneurial characteristic is another factor that could be associated with acquisition of financial services. Managerial competency of the business owner/manager can impact on the acquisition of services. Entrepreneurial training provides decision makers with the ability to apply the acquired skills and use information in such away that will improve financial performance, development, growth and survival of micro and small enterprises. Table 4.15, shows the distribution of entrepreneurial training of the owner/managers.

Table 4.15: Entrepreneurial training of the owner/managers

Entrepreneurial Training	frequency	%
Yes	137	59.3
No	75	32.5
Non- committal	19	8.2
Total	**231**	**100**

Source: Researcher (2012)

The results showed that majority of the respondents 59.3 percent (n=137) had some professional training while 32.5 percent (n=19) had no entrepreneurial training. The rest of the respondents 8.2 percent were non-committal. Entrepreneurial training of the respondents was examined also in terms of gender. Table 4.16 presents the results between entrepreneurial training and gender.

Table 4.16: Entrepreneurial training and gender of the respondents

	Had Entrepreneurial training		
Gender	**Yes**	**No**	**Total**
Male	85	46	131
Female	52	29	81
Total	137	75	212

Source: Researcher 2012.

The results indicated that 64.9 percent (n=85) of the males had acquired some entrepreneurial training compared to 35.1 percent who had no such training. The female respondents with entrepreneurial training were 64.6 percent (n=51) compared to 35.4 percent without any entrepreneurial training. There was no significant difference in acquisition of entrepreneurial training between the male and female gender (χ^2 = 0.10, P = 0.918). Further examination of acquisition of entrepreneurial training was done with respect to various skills acquired. Table 4.17 presents the result of skills acquired.

Table 4.17: Training skills possessed by the respondents

Training skills	frequency	%
Accounts	20	15.2
Art and design	12	9.1
Business administration	13	9.8
Carpentry	8	6.1
Computer skills/IT	20	15.2
Tour guide/ tour operators	11	8.3
Receptionist	6	4.5
Secretarial skills	5	3.9
Sales and marketing	6	4.5
Hairdressing	34	25.8
Electrical engineering	15	11.4
Teacher	8	6.1
Had no skills	67	29.0
Welding	6	4.5
Total	**231**	**100**

Source: Researcher 2012

Majority of the business owner/managers (n = 67) representing 29% did not have any professional skills. Among those with training skills; 25.8% (n=34) had hairdressing skills, followed by those in accounting and computer skills at 15.2% (n=20) each. Electrical engineers were next at 11.4% (n=15). These were followed by those in business administration at 9.8% (n=13) and those in arts and design 9.1% (n=12). Others were tour operators 8.3% (n=11). Table 4.18 shows the relationship between acquisition of entrepreneurial training of business owners/managers and acquisition of financial services. The study tested the hypothesis that there is no relationship between professional training and acquisition of financial services.

Table 4.18: Relationship between acquisition of entrepreneurial training and acquisition of external financial services

	Application for external financial services after start up		
Undertaken Entrepreneurial training	**Applied for loan**	**Did not apply for loan**	**Total**
Yes	24(85.7%)	36 (67.9%)	60 (74.1%)
No	4 (14.3)	17(32.1%)	21 (25.9%)
Total	28 (100%)	53(100%)	81 (100%)
$\chi^2 = 3.019$			
P = 0.068			

Source: Researcher (2012)

The result of the analysis indicated that there was no relationship between entrepreneurial training and acquisition of financial services. Consequently regression analysis was not necessary. The hypothesis that there is no relation between entrepreneurial training and acquisition of financial services was therefore not rejected.

The finding is inconsistent with the popular belief that there is a relationship between entrepreneurial training and entrepreneurial success. Richard (2006) as cited in Fatoki and Asah (2011) had pointed out that when assessing requests for funding, the investors look out for managerial competence and characteristics of the entrepreneur which indicate investment readiness. Business owners/managers need therefore to be fully equipped and prepared for the business needs. Another differing view is by Thuranira (2009) who observed that level of literacy, prevent business owners/managers from accessing publications and advertisements for financial services and therefore fear applying for loans for lack of understanding. Entrepreneurial success can be positively associated with access to financial services. The finding of the study also differs with the finding by Fatoki and Asah (2011), who found that to access debt financing, business owner/managers, should be investment ready by among other things attending seminars and training programmes to improve on their managerial competence. The finding differs also with that of Njoroge and Gathungu (2013). Commercial banks and other financial institutions also look beyond the need for the funding when assessing requests for funding.

4.5 The Effect of Demographic Factors on Acquisition of Financial Services.

Demographic factors have critical influence in the decision making process especially financial decisions. The effects of demographic factors was analysed on the basis of gender, business income, number of employees and age of business owners/managers. At the onset the business owner/managers indicated awareness on the terms and conditions under which financial institutions lend to businesses. . Figure 4.1 presents the result of the frequency distribution for awareness of banks conditions for advances.

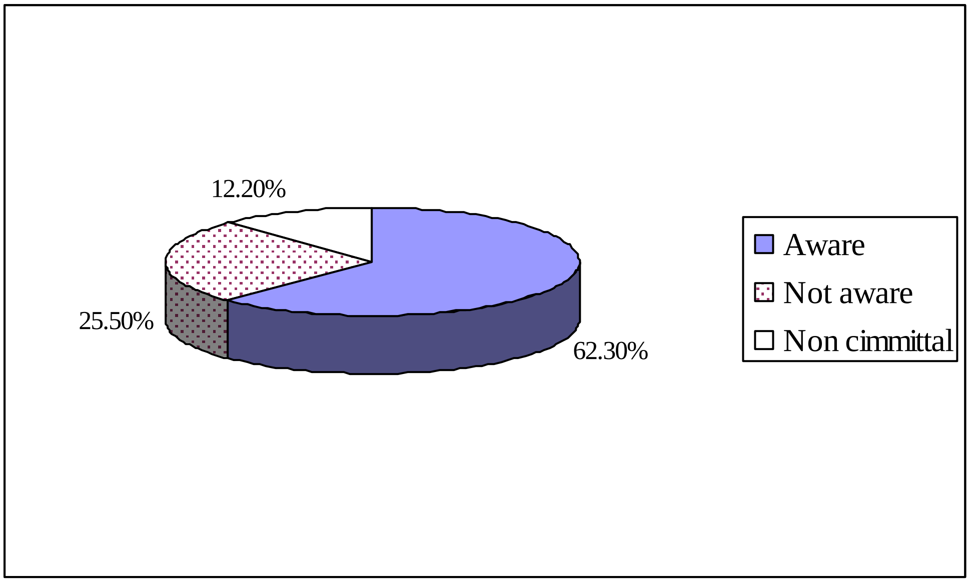

Figure 4.1: Respondents' awareness of the conditions for lending

From figure 4.1, it is indicated that majority of the respondents 62.3 percent indicated they were aware of the condition, 25.5 percent indicated they were not aware while 12.2 percent were non-committal. This is an indication that to a large extent, owners/managers of micro and small enterprises decision to apply or not to apply for a financial service is based on informed judgments.

4.5.1 Gender of Respondents

Gender is a significant factor in the development and growth of small and micro enterprises. Both male and females equally endeavor to own an enterprise either as the main occupation or as a secondary occupation. Table 4.9 presents the results of the gender distribution of the respondents.

Table: 4.19 Gender of respondents

Gender	frequency	%
Male	143	61.9
Female	88	38.1
Total	231	100

Source: Researcher (2012)

The results showed that majority of the respondents 61.9 percent (n=143) were male while 38.1 percent (n=88) were female. This showed that there was gender gap in the ownership of micro and small enterprises. The distribution of gender in terms of ownership is indicated by table 4.20 below.

Table: 4.20. Distribution of Ownership by Gender

Gender	Micro	Small	Other
Male	110(59.8%)	26(76.5%)	2(40%)
Female	74(40.2%)	8(23.5%)	3(60%)
Total	184(100%)	34(100%)	5(100%)

Source: Researcher (2012)

The distribution of ownership with regard to gender showed that 59.8 percent (n=110) of the micro enterprises are owned by males while 40.2 percent (n=74) are female owned. Of the small enterprises, 76.5 percent (n=260) are male owned as 23.5 percent (n=8) are female owned. The study also analysed the distribution of the form of business ownership as shown by table 4.21.

Table 4.21 Type of business ownership

Ownership	**frequency**	**%**
Jointly	65	28.1
Sole proprietor	152	65.8
Non- committal	14	6.1
Total	**231**	**100**

Source: Researcher (2012)

The form of business ownership is critical since it has a bearing on the value of capital that a firm is capable of raising at a given point in time. Majority of the sampled businesses, 65.8 percent were sole proprietorships while 28.1 percent were jointly owned. A business that is owned by one person is likely to be undercapitalized. Those who own micro and small enterprises as secondary occupations employ managers or allow their partners to handle the day to day operations.

In order to determine the relationship between the gender of business owner/manager and acquisition of financial services, chi-square test was carried out on the relationship between gender and startup capital table 4.22.

Table 4.22 Relationship between gender and startup capital

	Startup capital				
Gender	**Below 10,000**	**10,001 – 20,000**	**20,001-30,000**	**Above 30,000**	**Total**
Male	23 (18.9%)	20(16.4%)	17 (13.9%)	62(50.8%)	122 (100%)
Female	11 (13.9%)	25(31.6%)	12 (15.2%)	31(39.2%)	79 (100%)
Total	34 (16.9%)	45 (22.4%)	29 (14.4%)	93 (46.3%)	201 (100%)
Chi- value	7.113				
P-value	0.068				

Source: Researcher 2012.

The result indicated that majority of the male respondents (50.8 percent) used more than Ksh.30, 000 to start up their businesses compared to (39.2 percent) of the female respondents who used more than Ksh. 30,000 for startup capital. The chi-square result was (χ^2 = 7.113, P = 0.068). This was an indication that gender of the owner/manager did not influence startup capital. The study examined also the relationship between gender and acquisition of financial services. The following table 4.23 shows the results.

Table 4.23: **Relationship between the gender and loan acquisition**

	Loan application		
Gender	**Yes**	**No**	**Total**
Male	17 (34.0%)	33(66.0%)	50 (100%)
Female	12(35.3%)	22 (64.7%)	34(100%)
χ^2-value	0.015		
P-value	0.903		

Source: Researcher (2012)

The result showed that the act of applying for a loan and gender of business owner/manager are not related since the p-value was >0.05. The hypothesis that there was no relationship between gender and acquisition of financial services was not rejected. This finding is inconsistent with the findings of previous studies. Renzulli *et al*. (2000) found that women have fewer networks among the faculty which limits their ability to access business resources and finance. The banks in evaluating loan requests go deeper even to the socialization process (Carter *et al*., 2007). The social forces make it difficult for women to access some business services. Murray (2004) observed that one avenue by which people get involved in commercial activity is through social networks. Olsen and Cox (2001) and Fehr- Duda *et al.* (2004) explained that gender gap exist because of fear of risk by women, and women professionals and their attitude towards money.

Women are generally more risk averse than men with regard to financial decisions. Women tend to place greater weight on loss potential rather than large probabilities of gain. Muriel and Vesterlund (2005) attributed the existence of gender gap to differential attitudes towards competition. Women tend to dislike more competition than men. This might not be in all cases as many women have come out competing in all areas of life. Stephan and El-Ganainey (2006), in their investigation of the gender face of Venture Capital firms found that 90 percent of the individuals were men. This indicated that financial firms prefer males to females.

4.5.2: Level of Business Income and acquisition of Financial Services

Income is the main reason behind any business venture irrespective of the size of business. Income is therefore one of the key factors in the success of a business. The general perception is that income is one of the factors which have influence on business sustainability. Businesses with low level of income would generally find it constraining to sustain their operations. Businesses which record low levels of income are less likely to sustain their operations and grow. The study therefore sought to determine the relationship between level of business income and acquisition of financial services by micro and small enterprises. Table 4.24 shows the results of the descriptive statistics on business level of income.

Table 4.24: Level of Business Annual Income

Annual income (Sh.)	frequency	%
Below 100,000	59	25.5
100,000 – 200,000	56	24.2
201, 000 – 300,000	37	16.0
Above 300,000	48	20.8
Non –committal	31	13.4
Total	**231**	**100**

Source: Researcher (2012)

From table 4.24 it is observed that majority of the respondents 25.5 percent (n=59) had annual income of less than sh.100, 000; 24.2 percent (n=56) were at between sh.100, 000-200,000. The others were 16.0 percent (n=37) were at between sh. 200,001-300,000 while 20.8 percent had annual income of above sh. 300,000. Others who were non-committal were at 13.4 percent (n=31).

As a general practice, financial institutions require applicants for loans to provide evidence of their ability to service the facilities requested. Level of business income is one of the factors that banks for example ask the applicants to provide. The study sought to find out if there was any relationship between level of business income and acquisition of financial services. The findings are provided by Table 4.25.

Table 4.25: Relationship between Level of Business Annual Income and Acquisition of Financial Services.

Application for loan	Level of annual Income (Ksh)			
	Below 100000	**100001 – 200000**	**2000001-300000**	**Above 300000**
Yes	**2** (14.3%)	**6** (26.1%)	**10** (55.6%)	**11** (45.8%)
No	**12** (85.7%)	**17** (73.9%)	**8** (44.4%)	**13** (54.2%)
χ^2-value	**7.759**			
P-value	**0.051**			

Source: Researcher (2012).

From the findings indicated in table 4.25, it was observed that at 5 percent level of significance, there was a remote relationship between level of business income and acquisition of financial services as the p-value was >0,05. The correlation result indicated that the coefficient (β) was -0.123 with a p-value of 0.389. The result was not statistically significant. The hypothesis that there was no relationship between level of business income and acquisition of financial services was therefore not rejected at 5 percent level of significance.

The study also investigated the relationship between start-up capital and level of income. Table 4.26 provides the results.

Table 4.26: Relationship between Start- up capital and Level of annual business income

	Annual income (Ksh.)				
Startup capital (Ksh.)	**Below 100,000**	**100,001-200,000**	**200,001-300,000**	**Above 300,001**	**Total**
Below 10,000	23(67.6%)	7 (20.6%)	2 (5.9%)	2 (5.9%)	34(100%)
10,000 20,000	16 (35.6%)	20 (44.4%)	5 (11.1%)	4 (8.9%)	45(100%)
20,00– 30,000	8 (28.6%)	8 (28.6%)	8 (28.6%)	4 (14.3%)	28(100%)
Above 30,000	11 (12.5%)	20 (22.7%)	21 (23.9%)	36 (40.9%)	88 (100%)
(χ = 59.620 p-value=0.001					

Source: Researcher (2012)

From the result indicated by the test of association, it is noted that there was a relationship between startup capital and business annual income as p-value was < 0.05. To further investigate the influence of startup capital on business annual income, correlation analysis was carried out. The results are provided by table 4.27.

Table 4.27: Relationship between Start- up capital and Level of annual business income

	Annual income (Ksh.)				
Startup capital (Ksh.)	**Below 100,000**	**100,001-200,000**	**200,001-300,000**	**Above 300,001**	**Total**
Below 10,000	23(67.6%)	7 (20.6%)	2 (5.9%)	2 (5.9%)	34(100%)
10,000-20,000	16 (35.6%)	20 (44.4%)	5 (11.1%)	4 (8.9%)	45(100%)
20,00– 30,000	8 (28.6%)	8 (28.6%)	8 (28.6%)	4 (14.3%)	28(100%)
Above 30,000	11 (12.5%)	20 (22.7%)	21 (23.9%)	36 (40.9%)	88 (100%)
r = 0.494 p-value=0.001					

Source: Researcher (2012)

Majority of the firms, 67.6 percent with start- up capital below Ksh.10, 000 had accumulated annual income of not more than Ksh.100, 000 compared to 20.6 percent who had accumulated annual income of between Kshs.100, 000 – Kshs.200, 000 and 11.8 percent with accumulated income from Kshs.201, 000 and above had startup capital above Kshs.30, 000. From the results indicated by table 4.27, it was observed that there was a positive relationship between start- up capital and level of business annual income. Since small businesses start with low value of capital, they tend to realize low levels of income which could eventually lead to the death of the MSEs.

Correlation analysis was further used to determine the influence of business income on the acquisition of financial services. Figure 4.2 shows the distribution of views of the respondents on accessibility of loans.

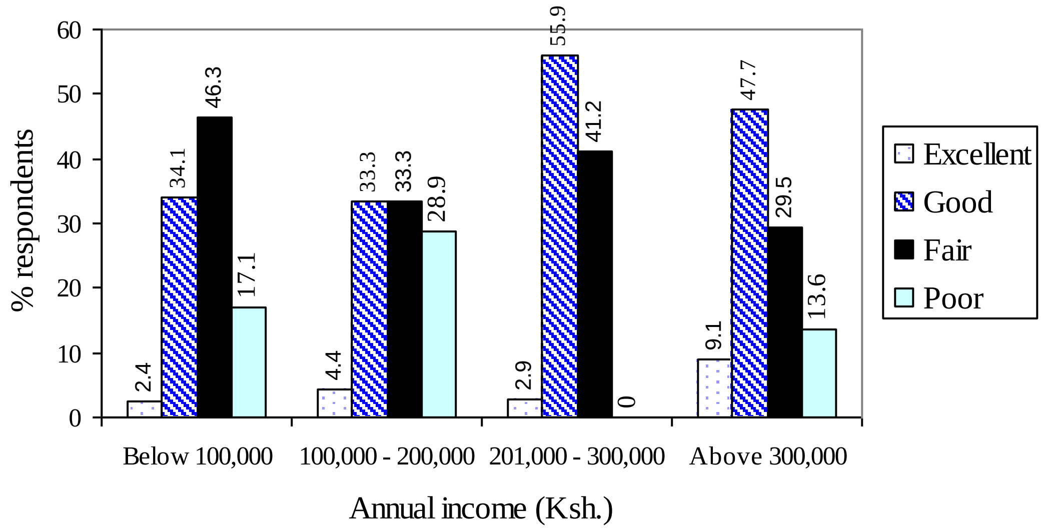

Figure 4.2: **Respondents Views on accessibility to Loans.**

Source: Researcher (2012

Correlation results indicate that businesses with higher annual income rated accessibility to bank loans as good. Out of the sampled population, 3.5 percent rated accessibility as excellent while 32.0 percent of the respondents rated accessibility to loans from commercial banks as good. The rest 64.5 percent of the respondents rated accessibility to loans from commercial banks as poor. This is an indication that even with the liberalization in the banking sector many small and micro enterprises still have challenges accessing loans from commercial banks. A strong relationship was established between level of annual income and accessibility to loans from commercial banks (r = - 0.194, P = 0.013). Table 4.28 presents the results of Spearman ranks correlation.

Table 4.28: A Spearman ranks correlation table for the MSE accessibility to bank loans and their annual income

	Level of income (Ksh.)			
Accessibility of loan rating	Below 100000	100000-200000	200001-300000	Above 300000
Excellent	1 (2.9%)	2(4.4%)	1 (2.9%)	4 (9.1%)
Good	14(34.1%)	15(33.3%)	19(55.9%)	21(47.7%)
Fair	19(46.3%)	15933.3%)	14(41.2%)	13(29.5%)
Poor	7(17.1%)	13(28.9%)	0(0.0%)	6(13.6%)
Total	41(100%)	45(100%)	34(100%)	44(100%)
r = -0.194				
P = 0.013				

Source: Researcher (2012)

On level of income and application of bank loans, the result showed a weak relationship. The chi-square test result was χ^2 = 7.113, with a P-value of 0.068. The number of firms applying for bank loans after the startup capital appeared to increase with increase in level of business income as shown in table 4.28. The study also analysed the relationship between level of income and other economic factors of: need for bank account, collateral, guarantee, profitability and rate of interest as captured in Table 4.29.

Table 4.29 Correlation between level of business income and factors influencing acquisition of financial services by MSEs

	Need for bank account	influenced by collateral	influenced by guarantee	influenced by profitability	influenced by interest rate
indicate the level of your income annually in shillings	r = -0.086	r = -0.062	r = -.027	r = 0.109	r = 0.020
Spearman's rho	P = 0.327	P = 0.478	P = 0.755	P = 0.214	P = 0.817
	N = 132	N = 133	N = 131	N = 131	N = 131

Source: Researcher (2012)

Table 4.29 shows that respondents in businesses which had lower annual income, lowly ranked (5) influence of loan application by need for a bank account (r = -0.086, P= 0.327), influence by collateral (r = -0.62, P = 0.478), influence by guarantee (r = – 0.027, P = 0.755), influence by profitability (r = -0.109, P = 0.214) and influence by interest rates (r = -0.020, P = 0.817). This implied that relatively, MSEs which had smaller levels of annual income were not influenced by these factors. Businesses which had higher annual income indicated their loan applications were influenced by all the tested factors. Correlation results indicated that businesses with higher annual income rated accessibility to loans as good. Since the p-value of each factor was > 0.05, all the factors were found to be independent of annual income of micro and small enterprises.

4.5.3 Firm Size and acquisition of financial services

Firm size is an indicator of level of activities of a firm. High levels of activities on the other hand imply high demand for resources including financial resources. Number of employees engaged by a firm can be an indicator of firm size. For this study firm sizes based on the number of employees of the firms including the owner is provided by Table 4.30.

Table 4.30: Position in business and number of business employees

	Relationship with the business			
Employees	**Owner**	**Manager**	**Others**	**Total**
1 – 9	134 (73.2%)	19 (10.4%)	30 (16.4%)	183 (100%)
10 – 50	16 (47.1%)	12 (35.3%)	6 (17.6%)	34 (100%)
0ver 50	0 (0%)	2 (40.0%)	3 (60.0%)	5 (100%)
Total	150 (67.6%)	33 (14.9%)	39 (17.6%)	222 (100%)
χ^2 = 25.774				
P = 0.000				

Source: Researcher (2012)

Micro businesses having 1 – 9 employees were 73.2 percent and were managed by the owners compared to 10.4 percent which were managed by hired managers. Small firms with 10 – 50 employees including owners and managed by owners were 47.1 percent compared to 35.3 percent. Research findings showed that there was a strong association between number of employees and ownership of the businesses as; (χ^2 = 25.774, P = 0.001). Businesses having fewer employees are owned by individuals as opposed to those having more employees.

The study sought also to find out existence of any association between firm size and loan application amongst micro and small enterprises. Firm size is one of the firm characteristics that was found to impact on the capital structure and performance of small and micro enterprises (Sorooshian *et al.*, 2010). The chi-square result of the relationship between firm size and acquisition of financial services is provided by table 4.31.

Table 4.31 Firm size and acquisition of financial services

	Number of Employees			
Loan Application	**1-9**	**10-50**	**Over 50**	**Total**
Yes	17 (26.6%)	12(60.0%)	0(00.0%)	29 (100%)
No	47 (73.4%)	8(40.0%)	0 (00.0%)	55 (100%)
Total	64 (100.0%)	20(40.0%)	0(00.0%)	84 (100%)
$\chi^2 = 7.537$				
P = 0.061				

Source: Researcher (2012)

Table 4.31 shows that only 26.6 percent (n=17) of businesses with between 1 employee and 9 employees had applied for loans while 73.4 percent had not applied for loans. For firms with between 10 and 50 employees including the owner, majority 60 percent (n=12) had applied for the loans while 40 percent (n=8) had not applied for the loans. Based on chi-square results it is observed that acquisition of financial services was independent of the firm size. Since the p-value was > 0.05, the hypothesis that there was no relationship between firm size and acquisition of financial services was not rejected.

To further understand the relationship between firm size and acquisition of financial services, correlation analysis was carried out to determine the influence of the number of employees of a business on acquisition of financial services. Table 4.32 presents the findings of effect of the number of employees of a business on acquisition of financial services.

Table 4.32: Firm Sizes and Acquisition of Financial Services

Spearman's rho	**Existence of bank account**	**Influenced your loan application by collateral**	**Influenced your loan application by guaranty**	**Influenced your loan application by profitability**	**Influenced your loan application by interest rates**
Number of employees the business have	r = -0.008	r = 0.023	r = 0.089	r = 0.054	r = -0.002
	P = 0.936	P = 0.815	P = 0.357	P = 0.579	P = 0.982
	N = 111	N = 110	N = 109	N = 109	N = 110

Source: Researcher (2012)

The findings showed that businesses which had higher number of employees highly ranked influence of need for bank accounts (r = 0.008, P = 0.936) and interest rates (r = 0.002, P = 0.982) than those which had lower number of employees. On the other hand, businesses which had lower number of employees highly ranked collateral number 1 (r = 0.023, P = 0.815) followed by guarantee (r = 0.089, P = 0.357) and profitability (r = 0.054, P = 0.579) than those business that had more employees. Since in the cases the p-values were > 0.05 at 95 percent level of significance, the hypothesis that there was no relationship between firm size and acquisition of financial services was therefore accepted.

The finding is inconsistent with the finding of Fatoki and Asah (2011) who found a positive relationship between the size of the SME and access to debt from commercial banks. Micro and small enterprises are small both in terms of number of employees and value of assets. They are therefore unlikely to access debt from commercial banks.

4.5.4 Age of respondents and Acquisition of Financial Services

Experience is an important factor for successful development and growth of a business. The study examined existence of any association between age and acquisition of financial services. Table 4.33 presents the results of the distribution of age of the respondents in this study.

Table: 4.33 Age distribution of the owner/manager

Age (Years)	**frequency**	**%**
18 – 28	87	37.7
29 – 39	82	35.5
40 – 49	51	22.1
50 and above	11	4.8
Total	**231**	**100**

Source: Researcher (2012)

The results indicated that a higher number of respondents 37.7 percent (n=87) were between 18 – 28 years, 35.5 percent (n=82) between 29 – 39 years, 22.1 percent (n=51) were between 40 – 49 years while 4.8 percent (n=11) of the respondents were above 50 years. In terms gender, more female 42.4 percent (n=36) were in the age group of 18-28 years as compared to male respondents at

36.6 percent (n=48). The mean age of the respondents was 34 years, implying that MSE entrepreneurs are mainly persons below 40 years of age. The result is consistent with the findings by Hisrich (2002), Jagongo (2012), Chiliya and Mornay (2012) and Ochola (2013).

The study further sought to find out the relationship between the respondents and the businesses. The result is provided by table 4.34.

Table 4.34 Respondents relationship with the business

Relationship	**frequency**	**%**
Owner	153	66.2
Manager	34	14.7
Others	44	19.1
Total	**231**	**100**

Source: Researcher (2012)

From the results it is revealed that majority of the businesses, 66.2 percent were owned by the respondents while 14.7 percent of the respondents were managers. With another 19.1 percent (n=44) never stated their relationship with the businesses. As indicated by table 4.35, the study sought to also find out the relationship between age and ownership of businesses.

Table.4.35 Respondents of various age relationship with the business

	Relationship with the business			
Ages (Years)	**Owner**	**Manager**	**Others**	**Total**
18 – 28	51 (58.6%)	14(16.1%)	22 (25.3%)	87 (100%)
29 – 39	55 (67.9%)	11 (13.6%)	15 (18.5%)	81 (100%)
40 – 49	38 (74.5%)	8 (15.7%)	5 (9.8%)	51 (100%)
50 and over	9 (81.8%)	1 (9.1%)	1 (9.1%)	11 (100%)
Total	153 (66.5%)	34 (14.8%)	43 (18.7%)	230 (100%)
$\chi^2 = 6.888$				
P = 0.331				

Source: Researcher (2012)

Among the various age groups, 58.6 percent (n=51) of those in the age group of 18-28 years owned the businesses while the rest were managers and other employees. In the age category 29-39 years 67.9 percent (n=55) owned the businesses while managers were 13.6 percent (n=11) and other employees were 18.5 percent (n=15). In the third category of 40-49 years, 74.5 percent (n=38) owned the businesses, 15.7 percent (n=8) were managers while employees were 9.8 percent (n=5). For those in age group of 50 years and above, 81.8 percent (n=9) own the businesses, 9.1 percent (n=1) own the businesses and 9.1 percent (n=1) as shown by table 4.40 compared to younger entrepreneurs. From the result it was noted that the relationship was not significant among the different age groups (χ^2 = 6.888, P = 0.331).

The study further sought to find out the relationship between age of business owner/manager and acquisition of financial services. Table 4.36 shows the distribution of age of respondents and their relationship with acquisition of financial services.

Table 4.36 Age of respondents and loan application

	Age of respondents				
Loan Application	**18-28**	**29-39**	**40-49**	**50 and over**	**Total**
Yes	4 (13.8%)	12(41.4%)	12(41.4%)	1(3.4%)	29 (100%)
No	26 (47.3%)	19 (34.5%)	8 (14.5%)	2 (3.6 %)	55 (100%)
Total	30 (35.7%)	31 (36.9%)	20(23.8%)	3 (3.6%)	84 (100%)
$\chi^2 = 11.944$					
P = 0.008					

Source: Researcher (2012)

Those who applied for bank loan fell between 29 and 49 years age bracket compared to those who did not apply. Majority of those who did not apply fell between 18 and 28 years age bracket. Between 18 and 28 years age bracket only 13.8 percent (n=4) applied for loan as compared to 47.3 percent (n=26) who did not apply. In the age bracket of 29 and 39 years 41.4 percent (n=12) for those between 29 and 39 years had applied compared to 34.5 percent (n=19) who had not applied. For age bracket 40-49 years, 41.4% (n=12) applied compared to 14.5 percent (n=8) who had not applied. For those above 50 years 3.4 percent (n=1) applied while 3.6 percent never applied. Table 4.44 shows a clear pattern in the number of those not applying for loan declining as age increases. From the chi-square test result, it is observed that there was a relationship between age of owner/managers of businesses and acquisition of financial services (χ^2 =11.944, P- value = 0.008). The hypothesis that age of the owner/manager has no relationship with acquisition of financial services was therefore rejected.

The study further, examined the relationship between age of the firm and acquisition of financial services. Enterprises take time to build their names and to develop goodwill. Firms which have operated for long are expected to have accumulated many assets and have collateral. A business with no track record or character may attract little interest either from suppliers of services, goods and capital or from customers. The study examined firms which had operated between 1 and 15 years. The age distribution of the firms is provided in Table 4.37.

Table 4.37: Age categories of businesses

Duration	frequency	%
1 – 5	116	50.2
6 – 10	74	32.0
11 – 15	21	9.1
Over 15	17	7.4
Non committal	3	1.3
Total	231	100

Source: Researcher (2012)

Asked how long they had operated their businesses most of the respondents, 50.2% percent said they had been in businesses for up to 5 years. The rest had operated for more than 5 years. 32 percent had operated up to 10 years, 9.1 percent for up to 10 years while 7.4 percent had been around for more than 15 years.

The study examined also the relationship between age of the businesses and acquisition of financial services. The result is presented in Table 4.38.

Table 4.38 Firm age and acquisition of financial services

	Age of respondents				
Loan Application	**0-5**	**6-10**	**11-15**	**Over 15**	**Total**
Yes	7 (17.5%)	16(53.3%)	4(50 %)	4(33.3%)	31 (100%)
No	33 (82.5%)	14 (46.7%)	4 (50%)	2 (67.7 %)	53 (100%)
Total	40 (100%)	30 (100%)	8(100)	6 (100%)	84 (100%)
χ^2 = 10.675					
P = 0.014					

Source: Researcher (2012)

Table 4.38 shows that majority of the firms which had operated upto 5 years, 82.5 percent (n=33) did not seek financial services as only 17.5 percent applied. For the firms ranging between 6 years to 10 years, majority, 53.3 percent (n=16) had applied compared to 46.7 percent (n=14) that had not applied for financial services. With firms of age between 11 years and 15 years, equal number 50 percent (n=4), had applied while the other 50 percent did not apply. For the rest of firms, 33.3 percent (n=4) applied and the rest 66.7 percent did not apply. The chi-square result was; (χ^2 =10.675, P- value = 0.014). This implied that the act of applying for a loan and age of the firm are dependent at 95 percent level of significance. This finding is consistent with the general practice. The finding is in support of the finding that there is a positive relationship between the age of the firm and access to debt finance from commercial banks (Fatoki and Asah, 2011).

4.5.5 Regression Results for Demographic Factors

Test for dependence was carried out between the demographic factors and acquisition of financial services. Based on the χ^2 –test results, only age of the respondents was found to have a strong relationship with acquisition of financial services with χ^2=11.944 and p-value=0.008 table 4.36. Firm size result was χ^2=7,537 with a p-value=0.061 table 4.31. Gender result was χ^2=0.015 with a p-value=0.903 table 4.23 and Level of business income was χ^2=7.759 with a p-value=0.051. In each of the factors, there was no relationship with acquisition of financial services.

Linear regression analysis was carried out to determine the extent of the effect of age on acquisition of financial services. The regression result is presented in table 4.39.

Table 4.39: Regression Results of Demographic factors on acquisition of financial Services

Variable	B	S.E	Wald	Sig.	Ex(B)
Age	-0.855	0.295	8.417	0.004	0.425
Constant	2.381	0.666	12.788	0.000	10.812

Source: Researcher (2012)

The result presented by table 4.39, indicated that acquisition of financial services was dependent on the age of the business owner/manager at 95 percent level of significance since p- value was < 0.05.The hypothesis that age of the owner/manager has no relationship with acquisition of financial services was rejected. The finding that age of the business owner/manager is a determinant of acquisition of financial services supports the findings of other earlier studies. Chiliya and Mornay, 2012) in the study of the impact of level of education and experience on profitability of small grocery shops in South Africa, noted that age of the owner/manager is one of the key factors that affect performance. Financial performance is critical for performance of firms. That makes age also to be a critical factor in acquisition of financial services. It was hypothesized that there is a relationship between age of the owner/manager and acquisition of financial services.

4.6 Economic factors and Acquisition of Financial Services

The relationship between Economic factors and acquisition of financial services was analysed in respect of need for maintenance of bank account, collateral, guaranty, profitability and rate of interest.

4.6.1 Maintenance of Bank Account

Maintenance of bank account could be a good starting point for acquiring financial services as it would enable an easier evaluating a loan application. The study sought to determine existence of any relation between maintenance of bank account and application of financial services. In determining the relationship between maintenance of bank account and acquisition of financial services, respondents were asked to indicate whether they maintained bank accounts. Table 4.40 presents the results of the influence of maintenance of bank account on loan application.

Table4.40: Maintenance of bank account and acquisition of financial services.

		Maintenance of Bank account		
Loan application		**Yes**	**No**	**Total**
Yes	F	29	0	29
	%	100.0	0.00	100%
No	F	50	3	53
	%	94.3	5.7	100%
χ^2	0.187			
P	0.996			

Source: Researcher (2012).

As indicated by table 4.40, 100% (n=29) of those who applied for bank loans after startup maintained bank accounts. Those with bank accounts but did not apply for a loan were 94.3% (n=50) compared to 5.7% (n=3) who did not apply and had no bank accounts. The chi-square result was χ^2 = 0.187 with P = 0.996. The chi-test results showed that between maintenance of bank account and acquisition of financial services, there was no relationship since the p-value >0.05. The correlation results showed that the coefficient (β) was -0.274 with a p-value of 0.049. The hypothesis that there was no relationship between maintenance of bank account and acquisition of financial services was not rejected. This was an indication that maintenance of bank account is not a condition for acquisition of financial services by MSEs. This is contrary to the popular perception that to apply for a loan one needs to hold a bank account. The study tested also need for bank accounts and acquisition of financial services. Based on a scale of 1-5 the respondents were asked to indicate the influence that maintenance of bank account had on their loan application. The results are indicated in table 4.41.

Table 4.41: Need for bank account and loan application

	Need for Bank Account					
Loan Application	**1**	**2**	**3**	**4**	**5**	**Total**
Yes	6 (23.1%)	1(3.8%)	4(15.4)	3(11.5%)	12(46.2%)	26(100%)
No	14(63.6%)	1(4.5%)	1(4.5%)	1(4.5%)	5(22.7%)	22(100%)
Total	20(41.7%)	2 (4.2%)	5(10.4%)	4(8.3%)	17(35.4%)	48(100%)
χ^2 = 8.609						
P = 0.072						

Source: Researcher (2012)

Table 4.41 shows that the relationship between need for bank account and application for a loan was absent since the chi-test result was χ^2 = 8.609 with P = 0.072. This finding is inconsistent with the current practice as banks only advance loans to their customers maintaining accounts with the bank. Businesses need to maintain a bank account in order to apply for a bank loan. Banks, on the other hand charge various levies on bank accounts. These charges, translate to operational costs for the account holders. For a business the cost has to be charged against trading profits.

4.6.2 Need for Collateral

Collateral is a key factor that bank consider when assessing loan applications. Many financial institutions especially commercial banks, ask for collateral when one is applying for a bank loan. However, many banks nowadays give unsecured loans to individuals. Table 4.42, indicates the distribution of respondents response to influence of collateral.

Table4.42: **Ranking the Influence by Collateral**

Rank	frequency	%
1	44	19.0
2	46	19.9
3	6	2.6
4	21	9.1
5	22	9.5
Non-committal	92	39.8
Total	231	100

Source: Researcher (2012)

Many respondents, 19 percent (n=44) ranked collateral at position one against other economic factors which influence acquisition of financial services. 19.9 percent (n=46) put collateral at number two. Those who ranked collateral third were only 2.6 percent (n=6) while 9.1 percent (n=21). Others, 9.5 percent (n=22) ranked collateral at position five while majority 39.8 percent (n=92), were non-committal.

Despite the existence of unsecured loans allowed by banks nowadays, collateral still plays a significant role in accessing financial services. Collateral provides some form of security in the form of transferable property to the lenders in the event of default by borrowers. Some financial institutions and banks put a condition on collateral for them to lend. Since majority of MSEs, lack collateral they seem to avoid applying for bank loans.

On a scale of 1-5 the business owner/manager indicated influence of collateral on their loan application. The results are shown in table 4.43.

Table 4.43 Collateral and loan application

	Need for collateral					
Loan Application	**1**	**2**	**3**	**4**	**5**	**Total**
Yes	5 (19.2%)	10(38.5%)	4(15.4)	2(7.7%)	5(19.2%)	26(100%)
No	6(27.3%)	8(36.4%)	6(27.3%)	1(4.5%)	1(4.5%)	22(100%)
Total	11(22.9%)	18(37.5%)	10(20.8%)	3(6.3%)	6(12.5%)	48(100%)
$\chi^2 = 3.403$						
P = 0.493						

Source: Researcher (2012)

Table 4.43 shows how the respondents ranked the influence of collateral on their loan application. Majority of the respondents 38.5 percent (n=10) of the respondents whose loan applications were influenced by collateral rated the influence moderately. Those who rated collateral highly were 19.2 percent (n=5) similar to those who rated collateral low. To test for dependence, Chi-square test was carried out and the result was; $\chi^2 = 3.403$ and $P = 0.493$ as shown by table 4.43. This indicated that loan applications and need for collateral were independent of one another. Banks and other financial institution some time prefer to mitigate on their potential risk by asking for collateral to support an applicant in case of default. Correlation results indicated that the coefficient (β) was -0.257 with a p-value of 0.068. The hypothesis that there was no relationship between need for collateral and acquisition of financial services was not rejected.

This finding supports the current practice of the banks and other financial institutions that due to competition provide small amount of loans without asking the applicants to provide collateral. The use of collateral is less likely in more concentrated markets (Jiménez, Salas, and Saurina, 2006). The finding is also in support of the finding by Calcagnini, Farrabullini and Giombini, (2009) who contended that collateral requirement is affected by credit market competition as collateral is only used to separate well from bad customers to reduce adverse selection problems. The finding is, however, against the findings of other previous studies. Bougheas, Mizen and Yalcin (2005) noted that collateral is an important factor for accessing external financing for small and medium enterprises. Fatoki and Asah (2011) also found that there is a positive relationship between collateral and access to debt finance by small and medium enterprises from commercial banks. This trend is likely to continue since there is a strong competition for customers in the Kenya banking sector.

4.6.3: Guarantorship and Acquisition of Financial Services

Another factor that banks and other financial institutions apply in reducing their potential risk is business guarantee. The study therefore sought to find out the influence of guaranty on loan applications. Table 4.44 indicates how the business owner/managers ranked the influence of guarantee on their loan applications.

Table 4.44 Guarantorship and loan application

			Need for guarantee and loan application			
Loan Application	**1**	**2**	**3**	**4**	**5**	**Total**
Yes	6 (23.1%)	5(19.2%)	9(34.6)	2(7.7%)	4(15.4%)	26(100%)
No	5(22.7%)	3(13.6%)	7(31.8%)	6(27.3%)	1(4.5%)	22(100%)
Total	11(22.9%)	8(16.7%)	16(33.3%)	8(16.7%)	5(10.4%)	48(100%)
$\chi^2 = 4.338$						
P = 0.362						

Source: Researcher (2012)

In addition to real collateral, banks and other lending institutions require guarantee in the form of unsecured promises. Results given in table 4.44 indicate that only 15.4 percent (n=4) felt that loan applications are influenced by guarantee. Majority of the respondents moderately ranked guarantee with 34.6 percent arguing that guarantee had a moderate influence. 23.1 percent (n=6) pointed out that guarantee is less likely to influence loan application. The chi-square result was χ^2 = 4.338 with P = 0.362. The result showed that loan application and guarantee are independent of each other since the p-value was > 0.05 at 95 percent level of independence. The result of correlation analysis revealed that the coefficient (β) was -0.148 with a p-value of 0.300. Based on the result, the hypothesis that there was no relationship between guarantee and acquisition of financial services was therefore not rejected.

The role of guarantee in lending has been widely discussed and recognized in the New Basel Capital Accord II that is concerned regulations for secured loans. The requirement that borrowers provide guarantee when requesting for financial services is extended to even micro and small enterprises especially after the recent global financial crisis. The overall effect of the global financial crisis was reduction of the available bank debts while at the same time increased the cost of the debts according to the report on UK SME financing. Smaller companies were most affected by credit crunch as a result of the tightening of the business credit standards and reduced availability of external financing to SMEs (Wehinger, 2014). The finding of the study is consistent with the finding of (Calcagnini *et al*, 2009) who in their study on the link between loans, interest rates and guarantees found that collateral and guarantee requirements are affected by market competitions. The finding is however, inconsistent with the finding of Pozzolo (2004) who noted that there is a positive relationship between guarantee and debt financing as real and personal guarantees are applied against moral hazard problems. Calcagnini *et al.*, (2009), further observed that in countries where economies are largely dominated small companies the provision real and personal guarantees has always played a significant role in facilitating the flow of credit to borrowers. This finding is consistent with the practice in Kenya where banks and other financial institutions advance unsecured loans due competition and to attract more customers among other reasons.

4.6.4: Profitability and Acquisition of Financial Services

Business profitability is one of the economic factors that may have influence on business acquisition of financial services. It is widely believed that firms with the potential to service banks facilities and other institutional obligations are likely to acquire financial services than those without the potential to service. Such potential can be demonstrated by the level of future profits of a firm. In liberalized economies profitability is a measure of performance. The study sought to determine the relationship between business profitability and acquisition of financial services. Table 4.45 provides the result of how the business owner/managers ranked the influence of business profitability in relation to acquisition of financial services.

Table 4.45: Profitability and acquisition of financial services

	Effect of profitability on acquisition of financial services					
Loan Application	**1**	**2**	**3**	**4**	**5**	**Total**
Yes	7(26.9%)	2(7.7%)	3(11.5%)	9(34.6%)	5(19.2%)	26(100%)
No	4(19.0%)	2(9.5%)	4(19.0%)	8(38.1%)	3(14.3%)	21(100%)
Total	11(23.4%)	4(8.5%)	7(14.9%)	17(36.2%)	8(17.0%)	47(100%)
$\chi^2 = 0.999$						
P = 0.910						

Source: Researcher (2012)

The chi-square test result was $\chi^2 = 0.999$ with P = 0.910). Correlation results showed that the coefficient (β) was -0.123 with a p-value of 0.389. The finding indicated that there was no dependence between business profitability and acquisition of financial services. The hypothesis that there was no relationship between business profitability and acquisition of financial services was thus not rejected. In capital structure theories, profitability affects the debt equity ratio.

According to the pecking order theory, profitability and debt financing have a negative relationship. Myers (1984) argued that firms follow a pecking order if they prefer internal finance to external funds. The theory asserts that profitable companies prefer internal financing to debt. The finding is in support of the finding that there is no relationship between profitability and debt, since the relationship between profitability and leverage is inconsistent with the pecking order theory as suggested by Shyam-Sunder and Myers (1999).

The finding is, however, inconsistent with the pecking order theory and the findings by other previous studies. Amonoo *et al.,* (2003), in the study of the impact of interest rates on demand for credit and loan repayment by the poor and SMEs in Ghana found a relationship between profitability and debt financing. The finding is also not in support of the finding by Hovakimian *et al.,* (2004) who found a negative relationship between profitability and debt level. The other inconsistency is with the finding by Morri and Cristanziani (2009) who found a positive relationship between profitability and capital structure. The capital structure theories are largely applicable to publicly quoted companies. Micro and small enterprises on the other hand largely operate on funds from their savings and loans from friends and family members.

4.6.5 Rate of interest and acquisition of financial Services

Interest is the incentive that would persuade a bank or any other lender to allow borrowing by a business or any other individual. The respondents were asked to rank the factors that influence their application for bank loans. Table 4.46 provides how rate of interest was ranked against the other factors in relation to the influence on acquisition of financial services.

Table 4.46: **Ranking of the Influence by interest rate of the banks**

Rank	frequency	%
1	48	20.8
2	11	4.8
3	12	5.2
4	19	8.2
5	47	20.3
Non-committal	94	40.7
Total	231	100

Source: Researcher (2012)

Not very many ranked rate of interest as number one factor. Those who considered interest as a critical factor in loan application were 20.8 percent (n=48). Almost a similar number 20.3 percent (n=47) did not consider rate of interest as significant. The variation could be an indication that majority of the micro and small enterprises do not seek external funds from banks and other financial institutions. This was demonstrated also by the large proportion, 40.7 percent (n=94) who did not rank interest rate against other factors.

The study tested the hypothesis that there was no dependence between rate of interest and acquisition of financial services by micro and small enterprises in Kenya. Table 4.47 shows how business owners/managers view influence of rate of interest on their loan application.

Table.4.47: Relationship between Rate of Interest and Loan application

Application for loan	frequency	%
Yes	131	56.7
No	34	14.7
Non-committal	66	28.6
Total	231	100

Source: Researcher (2012)

Majority 56.7 percent (n=131) would borrow if interest rates were low while 14.7 percent (n=34) stated they would not borrow even with reduced rates of interest. Others, 28.6 percent (n=66) could not state their position. This could be as a result of information asymmetry. The also examined the relationship between rate of interest with regard to initial source of capital. Table 4.48 provides the distribution of the views of business owner/managers whose initial source of capital was bank, on the influence of interest rate on their loan application. The chi-square result is provided in table 4.48.

Table 4.48: Rate of Interest and acquisition of financial services

	If Low Rate of interest would apply	
Source of initial capital	**Yes**	**No**
Yes	**19 (35.2%)**	**4 (25.0%)**
No	**35 (64.8%)**	**12 (75.0%)**
$\chi 2$-value	**0.580**	
P-value	**0.553**	

Source: Researcher (2012).

Based on the findings it was noted that 35.2 percent (n=19) of the firms whose initial source of capital was bank loan would apply again for a loan when rate of interest was low while 64.8 percent (n=35) stated they would not apply for a loan even when rates were reduced. For the firms which obtained capital from other sources, 25.0 percent (n=4) would apply for loan while 75.0 percent (n=12) would not apply loans even when rates of interest were low. The chi-square result was $\chi 2$=0.580 with a p-value=0.553). The result of correlation analysis showed that the coefficient (β) was -0.064 with a p-value of 0.658. It showed there was association since p-value was >0.05. The hypothesis that there was no relationship between rate of interest charged by banks and other financial institutions and acquisition of financial services was not rejected.

In finance literature, it has been observed that there is a positive relationship between interest rates and the riskiness of borrowers. Interest rates are higher for riskier and small borrowers (Brigham and Houston, 2009). Micro and small enterprises are generally small borrowers. Conventional perception is that banking institutions continue to view MSEs as costly and risky borrowers. Contrary to this perception Calice *et al*. (2012), found out that many banks consider SME segment to be strategically important, attractive and profitable. In Kenya for example, it was noted that the interest income from SMEs was 30 percent of the total interest income. In spite of the SME contribution in the interest income of commercial banks this study found that there was no relationship between interest rates charged by banks and acquisition of financial services by MSEs. Yet one of the factors conventionally believed to have effect on loan application is the rate of interest charged by lending institutions.

The finding of this study is inconsistent with the finding by Amonoo *et al.* (2003) who found a negative but statistically significant relationship between interest rate and demand for credit. It was noted that the negative relationship was as a result of SMEs aversion to borrowing due to high interest rates. Zachary (2013) in a study of the effect of interest rates on the demand for credit by SMEs in Nairobi County found that interest rate has a positive relationship with demand for credit. This result is likely as the entrepreneurs decisions may be driven more by the push for returns in a liberalized market than the cost of capital.

4.6.6 Regression Results for Need for Bank Account and acquisition of financial Services

Chi- test alone cannot provide direction and the strength of the relationship. Except for need for bank account, the other economic factors of collateral, guarantee, business profitability and rate of interest had no relationship with acquisition of financial services. To determine the strength of the relationship between need for bank account and acquisition of financial services, a linear regression was carried out. Table 4.49 presents the result of the linear regression was between need for bank account and acquisition of financial services by MSEs in Kenya.

Table 4.49: Regression Results of Need for Bank Account and acquisition of financial Services

Predictor variable	B	Std. Error	Wald	Sig.	Exp(B)	95% Confidence Interval for Exp(B)	
						Lower bound	Upper bound
Need for bank account	-1.723	.722	5.692	0.017	.719	.043	.735

The result presented by table 4.49 indicates that there was a strong relationship between need for bank accounts and acquisition of financial services at 95 percent level of confidence. The coefficient (β) was -1.723 with a p=0.017 that was less than 0.05.The coefficient was negative but statistically significant. Therefore need for bank account explains acquisition of financial services. The hypothesis that there is no relationship between need for bank account and acquisition of financial services was therefore not accepted. This finding is consistent with the general practice of financial institution since banks do advance loans in the absence bank accounts for the customers.

4.6.7: Testing of Hypotheses

After developing composite index for each objective, the study tested several hypotheses. The first hypothesis Ho_1 stated that there was no relationship between Legal and Regulatory framework. The second hypothesis Ho_2 stated that there was no relationship between level of education obtained by the business owner/manager and entrepreneurial training with acquisition of financial services by MSEs in Langata Sub County. Third hypothesis Ho_3 of the study was that there was no relationship between demographic factors and acquisition of financial services by MSEs in Langata Sub County. The fourth hypothesis Ho_4 stated that there was no relationship between economic factors and acquisition of financial services by MSEs in Langata Sub County.

Multinomial logistic regression analysis was used to determine the overall determinants of acquisition of financial services by MSEs in Langata Sub County of Nairobi County in Kenya. Table 4.50 provides the results of the regression analysis.

Table 4.50: Regression Results for Determinants of Acquisition of Financial Services

Predictor variables	B	Std. Error	Wald	Sig.	Exp(B)	95% Confidence Interval for Exp(B)	
Legal and regulatory framework	-19.721*	177909.924.	.0000	0.063	2.724E	0.000	0.000
Level of education and training	-145.833*	27386.487	.0000	0.010	2.160	0.000	0.000
Demographic factors	-73.464*	18984.084	.0000	0.004	1.244E	0.000	0.000
Economic factors	8.242	.0000	.0000	0.131	3824.6	3824.6	3824.6

Source: Researcher (2012). * implies that the coefficients are significant at 5 percent level of significance

Based on the findings of the composite index provided in table 4.50, it was noted that legal and regulatory framework had a p-value of 0.063 which was significant at the 5% degree of freedom. This indicated that there was a relationship with acquisition of financial services. The hypothesis that there was no relationship between legal and regulatory framework and acquisition of financial services was not accepted.

The results showed that level of education attained by the business owners/managers and entrepreneurial training acquired by owners/managers had relationship with acquisition of financial services. The regression results indicated a p-value of 0.010 which was significant at 5% degree of freedom. The hypothesis that there was no relationship between level of education and entrepreneurial training of business owners/managers and acquisition of financial services was not accepted since the p-value was < 0.05.

The study tested the hypothesis that there was no relationship between demographic factors and acquisition of financial services by micro and small enterprises in Langata Sub County. The regression result indicated there was a relationship with a p-value of 0.004. The hypothesis was not accepted.

On economic factors, the study finding was that there was no relationship between economic factors and acquisition of financial services. The p-value was

0.131 which was >0.05. The hypothesis that there was no relationship between economic factors and acquisition of financial services was therefore not rejected.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND POLICY IMPLICATIONS

5.1 Introduction

This chapter presents the summary of the study, conclusions and policy implications and areas of further research.

5.2 Summary of the Study

The study was carried out to investigate the determinants of acquisition of financial services by the micro and small enterprises. Descriptive research method was used to carry out the study. The general objective of the study was to investigate the determinants of acquisition of financial services by the micro and small enterprises Langata sub-county of Nairobi. The findings of the study were therefore based on the specific objectives of the study and the hypotheses tested. The first objective of the study was to determine the relationship between legal and regulatory framework and acquisition of financial services. Relationship with legal and regulatory framework was analysed in terms of status of business registration, maintenance of bank account, source of initial capital and maintenance of business insurance. The study result showed that there was a negative but significant relationship between the legal and regulatory framework and acquisition of financial services by micro and small enterprises.

The second objective was to determine the relationship between level of education and entrepreneurial training of the owner/manager of a business and acquisition of financial services. Based on the results and the interpretation of the results, it was found that there was a negative significant relationship between level of education and entrepreneurial training of the owner/manager of micro and small enterprises and acquisition of financial services. The hypothesis was therefore not accepted.

Thirdly, the study examined the relationship between demographic factors and acquisition of financial services. The objective was to establish the relationship between; gender, age of respondents, level of business annual incomes and; size of business and acquisition of financial services. The results indicated that demographic factors had a negative significant relationship with acquisition of financial services by micro and small enterprises. The other factors of gender, level of business annual income and size of business had no relationship with acquisition of financial services.

The fourth objective of the study was to determine the relationship between economic factors and acquisition of financial services. Based on the findings of the study all the factors; collateral, guaranty, profitability and rate of interest had no relationship with acquisition of financial services. The study found that economic factors had no significant relationship with the acquisition of financial services by MSEs in Langata Sub County of Nairobi County.

5.3 Conclusions

Firstly, the study concluded that legal and regulatory framework had effect on the demand for loans and credit from banks and other financial institutions. There was evidence that owners/ manager of registered businesses were likely to request for a subsequent loans than the business owner or manager whose businesses were not registered. It can therefore be hypothesized that there is a relationship between legal and regulatory framework and access to financial services from banks and the other financial institutions.

Secondly, the study concluded that Demographic factors had a positive influence on acquisition of financial services. Majority of the micro and small enterprises in Lang'ata Sub County of Nairobi County were owned and managed largely by the youths. There was evidence of ownership by the youths as majority of the owner/managers were in the age bracket of 29 years and 49 years. Thirdly, the study concluded that the average age of the business owners/managers was 34 years. It could therefore be hypothesized that age of the business owner/manager, gender, level of income and number of employees effect acquisition of credit or loan from a bank or a financial institution.

The study finally concluded that maintenance of bank account has effect on the demand for or other financial institutions. Based on the findings, there was evidence of accessing credit or bank loan or financial resources from other institutions by those who maintain bank accounts than those without bank accounts. In processing requests for credits or loans, banks consider potential risk of the loan and therefore evaluate customers on the basis of character.

5.4 Contribution to Knowledge

From the conclusions of the study, a number of new knowledge have emerged which can assist Kenyan economy achieve the Millennium Development Goals as well as Vision 2030. The study explained that Legal and regulatory framework had influence acquisition of financial services from banks and Microfinance. Institutions requesting for financial services are still required to comply for control and regulations. Secondly the findings explained that demographic factors influences acquisition of initial capital from savings, friends and family members that young businesses tend to rely more on equity financing rather than debt financing. The study also showed that level of education and entrepreneurial influences acquisition of financial services from financial institutions. Micro and small enterprises which are owned or managed by trained individuals can rely on debt financing in addition to equity. Due to complexity of acquisition of financial services from banks and other credits from financial institutions and the stringent repayment conditions, most of the small businesses rely on own savings and reinvested profits instead of debt financing. The Millennium Development Goals (MDGs) and the Vision 2030 are achievable if such knowledge are utilized.

5.5 Policy Implications

To enhance accessibility to financial services, the financial intermediaries and the government should work on a framework that relaxes the complexities in loans acquisitions. The study found that there was a link between the legal and regulatory frame work which need to be complied with which impede on the request for financial services. The study recommendation is therefore for the government to enhance accessibility to financial services by collaborating with the relevant financial intermediaries in working out on a framework that relaxes the complexities in loans acquisitions. This can enable more of the MSEs to easily acquire financial services.

The study found also that source of initial capital had a positive significant relationship with acquisition of financial services by micro and small enterprises. This will most likely encourage the business owners/managers to apply and take loans. This implies that the burden of using own savings to finance the businesses will shifted elsewhere.

The Central Bank of Kenya in consultation with the commercial banks and other financial institutions review the banking policy to allow for opening and operating bank accounts by increasing bank networks. The study finding showed that need for bank account had a positive significant coefficient with acquisition of financial services by micro and small enterprises in Kenya. This implied that banks and other financial institutions are willing to lend to those who have bank accounts. Maintaining a bank account for customers enable information sharing whenever one applies for loan as provided for by the Finance Act 2013. Maintenance of bank account also would improve credit worthiness of the business owners/managers. The banking Act and the finance Act be reviewed to allow for establishment of more banks with special emphasize on micro and small enterprises start-ups. A move in this direction would encourage more development of micro and small enterprises. As these businesses grow their financial demands will grow and they will turn to the formal financial sector.

The study found a link between demographic factors and acquisition of financial services. The study recommends that the Central Bank of Kenya and commercial banks and other financial institutions could have as part of their banking policy to encourage development of lending products specifically for different demographic groups.. Micro and small enterprises are started and run by people of different age groups, gender, and level of income and firm sizes. It is clear that government agencies such as Youth Development Funds (YDF) and Uweso Fund (UF) lend to youths and women but it is not clear whether the different demographic categories are taken care of in the schemes. Financial service providers should develop products which are inclusive enough to all demographic groups. Availability of such specialized financial services would encourage people encourage even low income earners to seek debt financing instead of equity. This move could reduce the problems of unemployment as well as reduce poverty.

The government should enhance entrepreneurship financial training, including cascading it through formal education system. The study found a link between level of education attained by business owner managers and; entrepreneurial training to have a significant relationship with acquisition of financial services by MSEs.

5.6 Limitations and Recommendation for further Research

The study was limited to Langata Sub County in Nairobi County. It was restricted to issues of legal and regulatory, education and training, demographic and economic factors from 2001. Due to limitations of time and financial resources, it was not possible to extend the study to cover all the eight Sub Counties. Being the first study after the new constitutional order getting information was equally a challenge. But these limitations did not affect the findings of the study.

In the course of literature review and analysis, factors such as political risk, market orientation, financial risk and economic growth pattern were encountered. These factors could also be playing part in acquisition of financial services. The study therefore recommends that further research be conducted in the following areas:

1. Financial market orientation in accessibility to financial services.
2. The effect of financial risk on growth of micro and small enterprises.
3. Role of political risk in the business of lending
4 A similar study be done in other counties

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APPENDIX I

RESEARCH QUESTIONNAIRE FOR ENTREPRENEURS

Introduction

The purpose of this questionnaire is to determine factors that relate to acquisition of financial services by micro and small enterprises in Langata division in Nairobi County. You are requested to give answers to the questionnaire by ticking and/or giving reasons as may be appropriate. Your responses will be treated with utmost confidentiality, and will not be used for any other purpose except for this scholarly work.

SECTION A:

General information:

1. Gender: Male [ ] Female [ ]
2. State your age in years

   18-28 [ ]

   29-39 [ ]

   40-49 [ ]

   50-and over [ ]
3. State your level of education?

   Primary [ ]

   Secondary [ ]

   College [ ]

   University [ ]
4. Do you have any professional training?

   Yes [ ] No [ ]
5. If yes to the above question state the skill

____

____

6. State your marital status

   Single [ ]

   Married [ ]

   Divorced [ ]

   Separated [ ]

   Widowed [ ]

SECTION B. (BUSINESS INFORMATION)

7. State your relationship with the business

   Owner [ ]

   Manager [ ]

   Other (specify) ____

8. State the source of your business idea.

   Self [ ]

   Parents [ ]

   Training [ ]

   Other (specify) ____

9. Is the business jointly owned?

   Yes [ ] No [ ]

10. For how long have you operated the business?

   1-5years [ ]

   6-10 years [ ]

   11-15 years [ ]

   Over15 years [ ]

11. Is the business registered with the registrar of companies?

Yes [ ]

No [ ]

If no to the above state why

____

12. Indicate how much your start up capital was.

Below 10,000 [ ]

10,001-20,000 [ ]

20,001-30,000 [ ]

Above 30,000 [ ]

13. State the source of initial capital.

Own savings [ ]

Loan from bank [ ]

Loan from friends [ ]

Loan from credit associations [ ]

Other (specify) ____

14. Reason for the answer to question immediately above?

____

____

15. If the source of initial capital was bank loan, did you acquire loan from bank or any other financial institution again? Yes [ ] No [ ]

If the answer is yes, state what was the purpose for the loan.

____

____

If the answer to question 15(b) is no, state the reason.

16. Including yourself how many employees does your business have?

1-9 [ ]
10-50 [ ]
Over 50 [ ]

17. State your main customers.

Individuals [ ]

Institutions [ ]

Other (specify) ______________________________

18. What is your process of getting customers?

Personal selling [ ]

Recommendation by previous customers [ ]

Advertisements [ ]

Other (specify) ______________________________

19. Indicate the level of your annual income in shillings.

Below 100,000 [ ]

100.000-200.000 [ ]

201.000-300,000 [ ]

Above 300,000 [ ]

20. Do you maintain a bank account?

Yes [ ] No [ ]

If answer to the above question is no, state why?

____

21. If the answer to the question No 21 is yes state type of account.

Current [ ]

Savings [ ]

What is your reason for choice of the type of account?

22. How do you conduct your selling?

Cash basis [ ]

Credit basis [ ]

Other (specify) ____

23. Do you have insurance for the business?

Yes [ ] No [ ]

If no, state why? ____

24. How do you rate the security for your business?

Very secure [ ]

Secure [ ]

Not secure [ ]

25 state reason for the answer to question 25 above.

____

26 Are you aware of any conditions that banks require for loan?

Yes [ ] No [ ]

If yes list some of the conditions

1.____

2. ____

3.____

4. ____

27 When you applied for a loan last were you asked for registration?

Yes [ ] No [ ]

28 How about location of your business

Yes [ ] No [ ]

29 Rank the following factors in their order of importance as they influenced your loan application.

Factor(s)	Rank				
	1	2	3	4	5
Existence of bank account Collateral Guarantee Profitability Interest rate					

30 State if accessibility to credit would make your business grow.

Yes [ ] No [ ]

31 Rank the following financial services in terms of your business needs.[1lowest and 5 highest]

Factor(s)	Rank				
	1	2	3	4	5
Payment Loans and credit Savings Money transfer					

32 State whether loan repayment period is a hindrance to loan application.

Yes [ ] No [ ]

33State if the interest rates would influence your request for loan.

Yes [ ] No [ ]

State the reason for the answer to question 33 above

____

34 Is the premise owned by the business?

Yes [ ] No [ ]

35 State the approximate value of your assets in shillings

Below 50,000 [ ]

51,000-100,000 [ ]

101,000 – 200,000 [ ]

Above 200,000 [ ]

36 What is your view on accessibility of loan from commercial banks.

Excellent [ ]

Good [ ]

Fair [ ]

Poor [ ]

37 Reason for answer to question 36 above.

____

38 What Suggestion(s) can you give to commercial banks in relation to MSEs financial needs?____

39 Rank the following challenges according to how they affect your business performance.

Constraints/Challenges	**Ranks**
Lack of demand	
Credit accessibility	
Shortage of raw materials	
Insecurity	
Lack of work sites	
Inappropriate tools and equipments	
Competition	
Book keeping	
Marketing	
Lack of finance	
Management	

40 Any other comments you would like to make?

____

41 Sate two things which in your opinion should be considered when processing loan application.

1)

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2)

THANK YOU VERY MUCH FOR YOUR TIME