

RAISING FINANCE FOR SMALL AND MEDIUM SIZED ENTERPRISES

A case study of Thika Municipality

BY:

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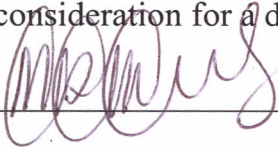


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DECLARATION

This research project is my original work and has not been presented anywhere for consideration for a degree in any other university.

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DEDICATION

To my parents, Paul Muturi and Mary Ruguru for who I am.

To my wife Purity Wawira for her patience and encouragement.

To my little children Ryan and Lorna for their great inspiration.

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DEFINITIONS

1.	SACCOS	Savings and Credit Co-operative Societies
2.	SMEs	Small and Medium Enterprises
3.	FAQs	Frequently Asked Questions
4.	MFI	Micro Finance Institutions
5.	KIPPRA	Kenya Institute of Planning Policy, Research and Analysis

APPRECIATION

My great appreciation is to the people who have made it possible to complete this work.

Am greatly indebted to my supervisor Mr. A. K. Khasiani for his support and guidance.

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The SME's owners in Thika cannot be forgotten for taking their time to fill in the questionnaire.

Am grateful to all.

ABSTRACT

SMEs are one of the fastest growing sectors of the economy. Each SMEs employs between 1 and 50 employees operating at a fairly small scale. In the recent past SMEs have been receiving a lot of attention by both the government and the donor community. The private sector is also now demonstrating interest through the formation of the various MFIs that have come up in the recent past.

This study seeks to identify the problems encountered by SMEs in their attempt to raise capital. It also seeks to identify the sources of information available to SMEs on the capital sources available to them and the sources of capital being used more often by the SMEs.

Whereas several forms of finance exist in theory, the study seeks to determine the availability of the various forms of finances, accessibility and the cost implications.

The study was conducted within Thika municipality in Thika district, central province of the Republic of Kenya. Thika municipality is an industrial town boosting of mainly small-scale family owned industries. It is a good representation of the SMEs sector in the country.

The studies aimed at assisting potential entrepreneurs anticipate potential difficulties in raising finance and develop possible solutions. It is intended to benefit the financial institutions by making them aware of the issues in raising finance to enable them develop suitable products. Scholars, Policy makers and other providers of capital will find the findings of this study useful.

In order to achieve the objectives, primary data on the business background, information sources, capital sources and their use was gathered. Primary data was collected from respondents in Thika Municipality using a self-administered questionnaire. Secondary data was also obtained from the existing literature specifically the FAQs brochures by lenders.

The analysis of the gathered data reveals that most SMEs ranked raising finance as the biggest obstacle to business expansion. Personal savings and trade credit of financing were more favored

than bank loans, Saccos and MFI's. Among the various sources of financing bank loans and Saccos were rated as expensive and / or inaccessible

From the findings of the study, it is fairly safe to conclude that a lot more information needs to be disseminated to the entrepreneurs on the ways and means of raising cost effective capital. Similar studies in other towns are necessary to shed a lot more light in this important growth factor of SMEs.

CHAPTER ONE

1.1 Background of the study

An important yet difficult task for the startup entrepreneur is to determine how much money is needed for the new business. If too little is raised the firm will be undercapitalized. If too much is raised unnecessary interest will be incurred and other investments foregone.

Undercapitalized firms usually run out of cash and have inadequate borrowing capacity. The lack of cash at a crucial moment, usually just before takeoff, may result in that firm going out of business. It is often said that for new firms 'cash is king' because when the entrepreneur runs out of cash, the king is dead and the business is lost.

The types and sources of financing available to the new venture depend on four factors namely: -

- ✓ The stage of business development
- ✓ The type of business and its potential for growth and profitability
- ✓ The type of asset being financed
- ✓ The specific condition of the financial environment within the economy

According to E. Waukin and J. Petty 1996, the elements of the overall financial environment that should be considered in such ventures are: -

- ✓ Level of interest rates/ the trend in the stock market.
- ✓ The existence of various financial institutions such as savings and loans commercial banks and international financial institutions.
- ✓ Level of confidence in the economy.
- ✓ Government monetary and fiscal policy.

1.2 Statement of the Problem

Capital is an important factor in business existence; failure to raise or difficulty in raising capital therefore spells danger. As with any business undertaking a focused approach is much more beneficial rather than a scattered approach.

In the recent past perhaps due to the scattered approach of assistance initiatives, Kenya has witnessed entrance and collapse of a huge number of small and medium enterprises. This study therefore seeks to find out the following:

- ✓ Do SMEs face problems in accessing financial assistance? Which ones?
- ✓ Are the initiatives to provide finance to SMEs focused and achieving results?
- ✓ Are any of the reasons for the collapse of SMEs related to raising finance?

1.3 Objectives of the Study

The general objective of the study is to identify the problems encountered by SME's in raising capital.

The study also intends to identify the information sources of SME's on capital sources and the sources of capital being used most often.

The specific objectives of the study were: -

- ✓ To establish the practical problems faced by SME's in raising capital.
- ✓ To establish the main sources of information SME's rely on the sources of finance.
- ✓ To establish the common sources of capital used by SME's.

1.4 Importance of the Study

The study will act as an eye opener to the practical problems faced by the SME's in raising finance; in particular the study will be useful to: -

- ✓ Potential entrepreneurs, who will become aware of the likely problems they will face in raising finance. It is going to enable them formulate the possible solutions.
- ✓ Financial institutions will benefit by being aware of the issues in raising finance. It can enable them develop suitable products to aid the SME's.
- ✓ Scholars and researchers will be able to compare and contrast the different circumstances surrounding the various business sizes and forms.
- ✓ Policy makers in their initiatives to promote SME's
- ✓ Other providers of Capital like Not-For-Profit NGO's

1.5 Scope and limitation of study

The study focuses on the general area of raising finance, with specific emphasis on the problems encountered by SME's in raising finance.

The focus is on the SME's within Thika Municipality. According to the business register maintained by Thika municipal council, there are a total of 1,897 businesses as the time of the study. Only a sample will be interviewed.

The scope of the study is be limited somewhat by the amount of time available for the research and also, the fact that not all SME's contact people will be willing to be interviewed for fear of imagined reprisals from Kenya Revenue Authority, County Council and Lenders.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

(Kilonzi 1992) says that it seems reasonable to suggest that the efforts of the Government of Kenya, International Aid Agencies and others to assist and encourage Kenyan small scale businesses, will be more productive if they identify and at the same time try to solve some of the problems facing these individuals and concentrate on small groups of entrepreneurs who have the desire and capacity to innovate, improve and expand their businesses. To scatter funds and technical assistance, among comparatively large number of entrepreneurs who have shown little or no capacity to meet business standards is in large part a waste of these scarce development resources.

A lot has been done to identify the problems facing small-scale enterprises both in Kenya and the outside world. Recently a lot of interest has been shown in the improvement of small-scale industries due to the various advantages accruing to them.

A number of studies carried out by scholars in this area includes Kessio 1981, Mwangi 1975, Hamper 1974, Mbuvi 1983, D E Wilde 1971, Child 1972, K Rep 1989; K Rep 1994, K Rep 1996, Wandungi 1994, Kilonzo 1992. All the scholars have made efforts to investigate reasons behind the poor performance of the small-scale businesses. However, none of the scholars specifically addresses the problems encountered by SME's in raising finance.

Kihungu G. M. (1993) sees the advantages of SMEs as follow,

- ✓ To set up small-scale business less capital is required compared to the amount required setting up a large-scale business.

- ✓ Small firms cut out most of the red tape prevalent in most large formal organizations. Customers and clients have direct access to ultimate decision maker.
- ✓ The employees of a well-managed small business derive social satisfaction. They have direct access to the top manager and can develop informal relationships. This contrasts sharply with the situation of large organizations in which an individual is either anonymous or a non-entity.
- ✓ Small business people usually adapt and interact with the society around it. The owner is part of the community. There exists mutual appreciation of the needs and constraints between customers and the firm. The customer develops loyalty, which would be of benefit to small business itself.
- ✓ The volume of output of a small business is usually small but it lends itself to provision of quality of products and services.
- ✓ Small firms are usually more flexible than large firms not only in size but output, location, market and product.

2.2 Characteristics of the micro- and small-enterprise sector

In Kenya, micro and small enterprises (SMEs) are defined as those employing not more than 50 employees. According to the Gemini SMEs 1993 survey, enterprises with more than 50 workers do not play a significant role in job creation. Indeed, this population is non-existent outside of commercial and industrial areas. Enterprises with 11 to 50 workers also play a minor role, comprising only 1% of enterprises nationally. It is the enterprises with 1 to 10 workers that make up 99% of the population of enterprises.

A common factor that constrains the growth of SMEs in Kenya is their tendency to start new businesses more often than expand within the same business. The typical entrepreneur in a rural shopping center will be running a very poorly stocked shop beside a butchery, a tea kiosk, a bar and a small shamba. Demand for expansion capital within the same line of business can be regarded as one of the indicators of business growth.

Such businesses with good growth potential, which can viably use credit of between Ksh.500,000 to Ksh.3 million, are considered as the 'missing middle' between informal SMEs served by MFIs and medium-sized formal businesses with access to bank credit.

Policy-makers should consider several key points when developing strategies.

First, strategy should focus on assisting enterprises within the MSE sector, rather than on assisting larger enterprises.

Second, the strategy should be able to reach rural businesses and home-based enterprises.

Third, female entrepreneurs face a different set of constraints than do their male counterparts.

2.3 Constraints in gaining access to credit

The K.I.P.P.R.A 2001 survey on “-Legal constraints in raising finance” concluded that Accessibility to credit in commercial banks is constrained by legal and regulatory factors as well as by stringent bank policies developed to counter risks associated with culture, attitude and cumbersome loan recovery procedures”. Some of the identified legal and regulatory constraints are summarized below.

(i) **Land Control Act**

Currently, agricultural land is accepted as security on a very selective basis, mainly because of the conditions imposed by the Act and also by the difficulties that lenders face when they try to realize their security.

The procedures, as stipulated by the Act and the decision-making processes, are cumbersome and time consuming. According to the Act, the Land Board can refuse to consent to the disposal of land if it believes the prospective buyer is unlikely to cultivate, develop or use the land profitably. The Act also applies double standards because the same conditions do not apply to urban properties. Finally, the Act gives the Land Board too much discretion, which has become a major source of discontent and abuse.

(ii) **Traffic Act**

Due to the difficulties encountered by lenders in trying to transfer ownership of repossessed vehicles, most lenders are reluctant to accept logbooks as securities for loans and those who do, deal only with new high cost vehicles knocking out most SME entrepreneurs.

(iii) **Hire Purchase Act**

The Hire-purchase Act requires the registration of all hire-purchase agreements of Ksh.300, 000 or less to make the agreement enforceable by law. Since most SMEs are looking for amounts in this bracket, it means their loans must undergo a registration process. This is a hurdle most SMEs find difficult to overcome due to the time, duration

of the process and costs involved. In addition, Section 12(1) of the Hire Purchase Act allows the client to terminate the agreement by returning the goods to the seller at any time before the final payment falls due, so long as a written notice of termination is submitted. This provision is clearly unattractive to financiers due to the risk of default. Therefore, lenders avoid hire-purchase agreements of amounts not exceeding Ksh.300,000. Section 15(1) of the Hire Purchase Act hinders the process of realizing collateral, discouraging banks and vendors from providing hire purchase credit.

(i) Culture of Default

The KIPPRA 2001 survey revealed that banks complained of a default culture in society, which seems to have been institutionalized by bureaucratic court procedures and processes. In some communities, if a bank tries to realize its security, the community ensures that no one bids at the auction. Where outsiders buy the property, they are harassed until they sell the property at a low price. The culture of default also underscores a widespread misuse of cheques to such an extent that some people have acquired a habit of issuing cheques, which bounce due to inadequate cash. This abuse has far-reaching consequences in relation to providing and using banking services. First, cheques are widely mistrusted and cannot be used to pay bills. Second, until recently the cheque-clearing process has been taking as long as 15 days. Third, again until recently the process to open a current account has been cumbersome and customer unfriendly. New customers had first to be recommended by first-class bank customers.

(v) **Security requirements and legal documentation**

To obtain credit from banks one requires security, which is supposed to be valuable property. Most SMEs entrepreneurs do not have valuable property. In addition, legal and valuation fees, processing and government charges raise the already high cost of capital and add an additional burden to a lengthy and cumbersome bureaucratic process. This further marginalizes SMEs. Currently its much easier for pay slip wielding SMEs employees to obtain personal unsecured loans than it is for their employers.

(vi) **Short Term Nature of Loans**

Commercial bank term lending is typically short term in nature. Evidence indicates that initial grace periods and extended repayment periods are attractive to customers. Banks are constrained in their ability to lend for longer terms primarily because of the relatively short-maturity profile of their deposit base and their desire to limit their liquidity risks. Banks require access to longer-term funds to meet their customers' capital project needs.

Recommendations (KIPPRA 2001 Survey)

To enhance the accessibility of services from commercial banks, the following recommendations are made:

The Land Control Act should be repealed.

The Traffic Act needs to be amended to strengthen the disposal rights of institutions that use logbooks as security for loans. In particular, provision should be made where the Registrar would, on being satisfied that a notice has been served, cancel the original logbook and issue a

new one. The lender would further be entitled to statutory compensation from the borrower for the associated costs caused by the delay to deliver the logbook.

Since bank shares, which are quoted in the Nairobi Stock Exchange, can be freely traded in the market it is recommended that Section 11(1)(a) of the Banking Act be amended to allow commercial banks to accept their own shares as collateral.

The hire-purchase mechanism should be revised to provide an alternative source of security of obtaining credit. Amending Section 12(1) to restrict the hirer from ending the agreement before the final payment could do this. In addition, Section 15(1) should be amended to allow the lender to enforce its rights even after two-thirds of the hire-purchase price has been paid

Whereas the law is clear, taking defaulters through the court process is lengthy and costly. It is recommended that this process be simplified and the number of judges increased so as to encourage banks to relax their lending criteria.

2.4 Some Of The Most Common Sources Of Funding To SMEs

Maiyo (1998) identified the most common sources of funding to Jua kali business as: loans from Saccos, savings, profits, customer deposits, credit facilities and members contribution. Out of all jua kali artisans 38.5% use their personal savings to finance their inputs, 19.2% finance their inputs from the profits made by the business; 17.3% finance from customer deposits, 11.5% from members' contribution, while 9.7% use credit facilities to finance their inputs.

It was found that only 9.7% use bank credit facilities to finance their inputs. A possible explanation for this small percentage may be due to lack of sufficient securities, restrictive credit policies, and general fear of business failures.

The policy implication here is that credit institutions and Government should encourage Jua kali artisans to use credit from financial institutions by amending lending policies particularly regarding collateral securities and other legal requirements.

Muturia (1996) tried to identify factors that influence flow of credit to small-scale enterprises from the point of view of SMEs and commercial banks. She suggested that businesses could obtain finance for operations and further expansion through contribution of capital by owners and by sale of goods and services and loans obtained from banks and other financial intermediaries.

A study done in Peru cited by Maiyo (1998), reveals that financial services for SMEs can be provided only if the income generated as a result of the provisions of these services is sufficiently large to cover all of the costs associated with it. Whether or not this is possible is conditional, in the first place, on whether the right financial products, which meet the demand exhibited by the target group are offered at the right price.

The vast majority of SMEs did not have access to loans extended by the banking system; and in those cases where businesses were able to obtain such finance, it was provided by intermediaries such as the state owned development banks, a Saving and Loan association and the Co-operative Bank. Many of such sources either went bankrupt or shut down as part of the banking sector reform.

SMEs obtained most of their capital through self-financing or by borrowing from family members. In Peru getting loans by pawning gold or silver jewelers as collateral was the savings banks response to the credit demand of SMEs. Due to problems involved in valuing and storing household appliances and other electrical equipment, the bank would only accept gold and silver

items as pledged assets thus limiting access to this type of financing to persons who owned such things.

2.5 Common Problems Faced By SMEs.

Mwangi (1975) in his study, "to evaluate the performance of the shopkeepers in the central province", conducted two surveys, the first one, "consumer opinion on small scale African Shopkeepers" and a second entitled "Salesmen's opinion on small scale African shopkeepers". The first one assessed the performance of these shopkeepers from the eyes of the consumer while the second assessed them from the eyes of the salesmen. In addition to these two, Mwangi also established a "standard of efficiency".

The standard of efficiency included (a) monthly sales turnover of goods, (b) accurate records of business transactions, (c) method and practice of purchasing which reduced amount of dead stocks, (d) the shop's appearance and use of display as a selling tool. . By use of these four criteria, it was possible to evaluate the performance of these businessmen and find out the problems afflicting them.

Mwangi concluded that these businessmen played a vital role by creating and increasing job opportunities and acting as training grounds for future entrepreneurs, in addition to the taking personal savings and other resources and putting them to productive use.

Like other researchers in this area Mwangi found that "lack of capital was repeatedly mentioned more than any other problem. Some of the small scale shopkeepers even disregarded any other

problems". Further probing and analysis indicates that the root cause of problems facing these traders is to be found in their cultural background and inadequate business training. Thus Mwangi recommended extension service to all small-scale African shopkeepers and development of an organization for small-scale business development, preferably under ICDC, with two arms focusing on the development of small-scale industries and small-scale shops.

This shows that Mwangi like Harper feels the problem that faces the African businesses is not capital but the inefficient use thereof and suggests an individual extension service to these small-scale retailers. He further argues that cultural constraints, such as extended family ties supercedes good credit control practice, this have worked against the performance of African businessmen and this problem would also be overcome by the extension service.

Marris and Sommerset (1971) found that two thirds of all the Kenya businessmen they interviewed believed that their greatest problem is shortage of capital and "few of the country shopkeepers thought of any other problem worth noticing"

McCrorry (1956) led a survey done on small businesses in one town in northern India and concluded that the need for capital was the principal reason for the lack of success of this sector.

Bosa (1966) observed that, among the many problems that confront small enterprise in underdeveloped – as opposed to developed countries, few have proven to be as difficult to solve as those of financing. And where African small businesses are concerned, these problems are even many, many times fold more intractable. He found that small business in Uganda – as in other parts of the world – depended very heavily on self-finance. In other words, family wealth was the largest source of finance for the highly successful businesses in Uganda. However, Bosa

established that where African businesses are concerned, this fundamental source of finance for small businesses was unavailable.

Kessio (1981) found that the most frequently recurring problem mentioned by businessmen interviewed as the most important in hampering the success of their businesses as the lack of finance.

De Wilde (1971), in a sample of seventeen countries in Africa confirms that a majority of African businesses consider financing their principal problem. He contends, however, that financing difficulties “reflect more basic problems of inadequate business skills and training.” He therefore, advocates that financing of African businessmen should be accompanied by effective measures to access the capacity for entrepreneurship.

Otieno (1988) observed that the major business problems on initiation included: lack of adequate capital, finding suitable working premises, finding customers, getting tools and implements getting raw materials, getting skilled workers, high license fee and lack of trustworthy employees. He concluded that small businesses suffer from inadequate institutional financing because of the aforesaid reasons; therefore making capital funds destined for such enterprises to lie idle.

Marris (1968) summarized the above researchers views when he stated that “ask any small African businessman what his principal problem is, and he will invariably say “money” or lack thereof”

Harper (1974) says, “The belief that the most pressing problem of small-scale businessmen is shortage of capital is not confined to Kenya. In New Guinea the small scale shopkeepers cannot understand why agencies set up to promote small businesses want to discuss profits, market, and such things when all they believe to be necessary is a loan. Even in a developed country like the United States, lack of capital is still considered, by small businessmen, to be their major difficulty”

Geiger and Armstrong (1964) says it is important to note that in order to assist small indigenous businessmen to use their resources efficiently and to meet increasing challenges, the financial assistance institutions, whether government or private, will have to expand and improve their facilities for providing technical assistance, training and education.

During a research on the development of private businessmen in Africa, both Geigner and Armstrong in 1964 observed, “virtually all African Governments have been better organized and more successful in training and education than in financial assistance programmes.”

In an attempt to tackle the social cultural problem that confronts the small scale African businessman, Marris (1968) in a paper “The Social Barriers to African Entrepreneurship” observed, “It is often contended, especially by Non-African researchers, that the obligations of the African extended family system inhibit the success and growth of African businessmen. Although these kinship ties might on the surface impede the development of successful businessmen, often they are a great advantage. They play an important role in contributing to other members of the family when starting a business”.

Geigner & Armstrong (1964) says “Virtually all the surveys on African business enterprises that have been made, testify to the importance of family contribution to initial financing”. Bauer (1963) discusses in detail the specific factors, which influenced the development of West African trade, with an emphasis on Nigeria. He also looked at the major constraints confronting the development of small African retailers and asserts that cultural problems, especially obligations of traditional family, could either be a deterrent or an advantage to the African trader.

De Wilde (1971) observed that when it came to making credit decisions many small-scale African businessmen did not succeed in making the decision objectively as is required many made the decision subjectively.

Bosa, (1989) looks at the Asian’s joint family system, which permits the generation and conservation of capital; he contrasts it with the African system of extended family,

Which diffuses resources. He argues that those affluent members of African society can comfortably live apart from their extended family and the rest of the other members of the society. This, however, is not possible for the rural area shopkeeper with his relatives next door. He will, therefore, experience a lot of pressure from the relatives, most of these pressures will not be to the benefit of the business but rather detrimental to it – either through investments which though prestigious do not make profit or uncontrolled credit to the rest of the members of the extended family.

Geigner and Armstrong in their book, “The development of African Private Enterprise”, attempted to examine the major problems confronting African private businessmen, especially in West and East African and the assistance programme that were meant to overcome the problems that were in existence. They concluded that “inadequate skills constitutes to more serious - though less intractable – problems than capital, for skill can be often substitute for and in itself is a major source of increased productivity and growth”.

Hawkings, (1965), studied wholesale and retail trade in Tanganyika and found out that there are three prime reasons why African traders have not progressed beyond their present stage in wholesale and retail trade. He mentions lack of commercial experience and basic knowledge of trading techniques as some of these reasons. He concludes, that what both the large and small African traders requires most seems to be advice and instruction, though the most frequently heard request is for loans.

Hirsch (1961) found that the Northern India small retailers did not know how to use funds for expansion because their low managerial ability limits the size of their businesses. Geertz (1974) says the lack of capital is apparently not the main problem in Indonesia, but rather the lack of ability to organize into one enterprise the diverse range of economic activity that make up small retail business.

It is true that capital may be scarce in most of these cases of small-scale enterprises but as Geiger and Armstrong (1964) point out, skills may be what are needed most; for skills may even increase actual productivity and prosperity may increase. The reverse is most unlikely – thus with more of capital and less of skills, the capital is likely to be wasted and eventually the business collapses.

Staley & Morse seem unhappy about this idea of loans and hold the new view that “loans must be denied until proper records are kept” Kilby and Sir W A Lewis (1962) states that “in Ghana African enterprises cannot be built by simply lending Africans money. To lend money to entrepreneurs who lack managerial capacity is merely to throw it down to drain”. Lewis and Hawkins (1965) recommends that loans should be given to a selected “few” after instruction on effective use. Mwangi (1975) carried out his study in Central Province in Kenya and found that shopkeepers did not keep adequate books of accounts or business records-that would provide useful information of running the business the business from day to day. The few who kept these records did not even make use of them. They just wanted to show them to the financial institutions to secure loans. This is a problem that has to be overcome by showing these traders that proper record keeping is an aid to proper running of the business rather than an aid to getting loans.

From the studies conducted on SMEs by various scholars, lack of finance features prominently as the reason for collapse, limited expansion, or non-start-up. They are various possible sources of raising finance but the SMEs seem not being able to access the sources.

2.6 Conceptual framework.

This study's underlying concept is raising finance in SMEs.

It will focus on the both the internal and external factors.

The internal factors that are deemed as independent variables are,

- ✓ Age,
- ✓ Activity,
- ✓ Number of employees,
- ✓ Annual turnover
- ✓ Form of ownership and
- ✓ Level of education of the entrepreneur

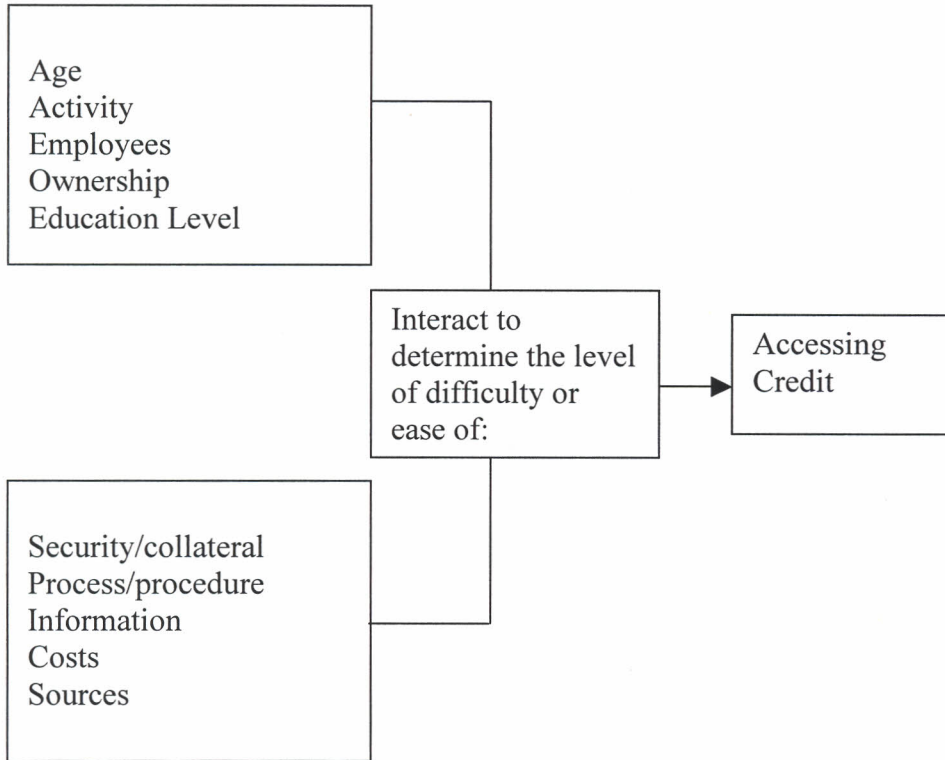
The external factors that are deemed dependent variables are,

- ✓ Sources of information and capital,
- ✓ Requirement and availability of securities,
- ✓ The costs and process involved

The variables identified will help isolate the difficulties or otherwise in raising finance in SMEs.

This relationship is captured below:

2.0 Conceptual Framework



The arrangement of the variables is not necessarily in the order of importance.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

This section gives a description of the methodology to be used in conducting the study. The section is divided into four parts namely; population of study, sampling plan, data collection procedures, and data analysis techniques.

3.1 Population of Study

The population of the study was made up of all SMEs listed in the business register maintained by Thika Municipal Council. At the time of the study, there were 1,897 SMEs registered.

The respondents were the entrepreneurs and the top management where employees largely run the business.

3.2 Sampling Strategy

Taking into account that there are a large number of SME's within Thika Municipality, a sample of 93 firms was selected. This is 5% of the population. This sample is considered large enough to provide a general view of the problems faced by SME's in raising finance and to provide a basis for valid and reliable conclusions. The population was stratified into three strata based on the location as shown below:

Area	Population size	Sample size
Central Business Area	507	25
Industrial Area	897	44
Residential Area	493	24
Total	1897	93

Simple Random Sampling was then used in each stratum using a sample without replacement method.

3.3 Data Collection Procedures

The study will rely on primary and secondary data. Primary data was obtained from the sampled respondents through questionnaires, while secondary data was obtained from the existing literature specifically the FAQs brochures by lenders.

A Questionnaire was used as the main instrument for data collection. Depending on the organization structure. The instrument contained both open ended and closed ended questions. The closed ended questions were used to obtain data that could be supported by information held in the firms' records, while the respondents used open-ended questions to obtain qualitative data including observations. Questions covered both sources of finance and difficulties in raising finance.

3.4 Data Analysis Techniques

Data collected was analyzed using descriptive statistics, which included percentages, mean scores and frequency tables.

CHAPTER FOUR

4.0 DATA ANALYSIS AND INTERPRETATION

The main objective of this study was to identify the problems faced by small and medium enterprises in raising finance.

This section presents the summarized data from the questionnaire completed. The data is presented in form of frequency tables and percentages.

Means and rankings were calculated for Section B of the questionnaire.

Out of the 93 questionnaires issued only 77 were returned.

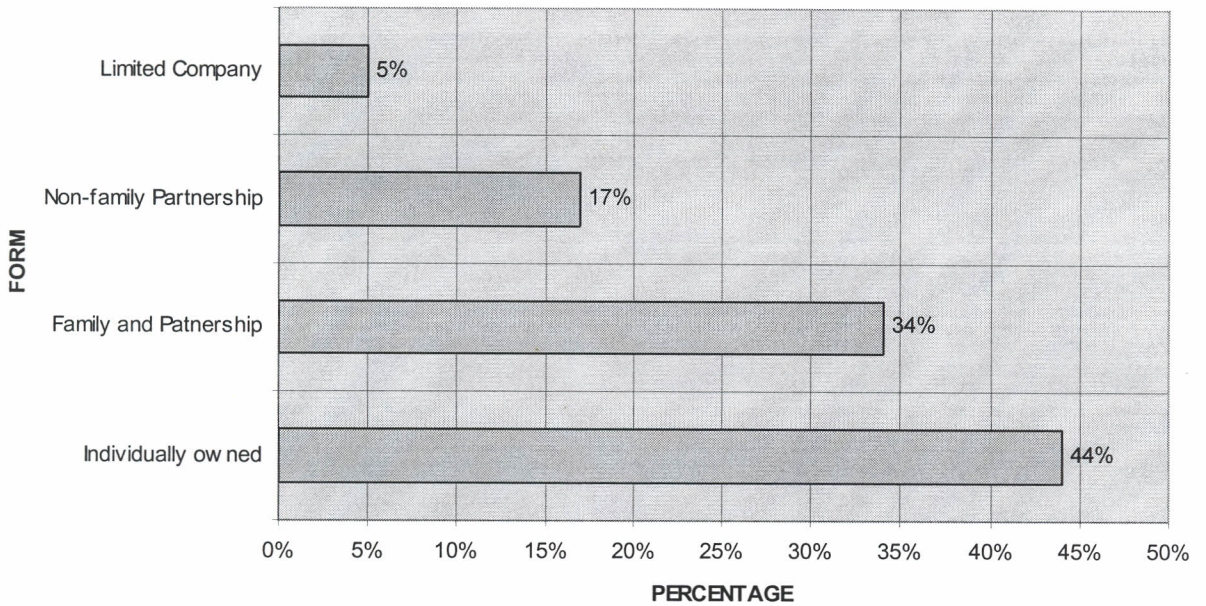
Table 4.1: Type of business ownership

This question was to establish the various forms of business ownership that most SMEs apply. The choices offered were individually owned, family partnership, non family partnership, and limited companies. The results were as below.

FORM	FREQUENCY	PERCENTAGE
Individually owned	33	44%
Family and Partnership	26	34%
Non-family Partnership	14	17%
Limited company	4	5%

Source: Research findings.

Type of Business Ownership



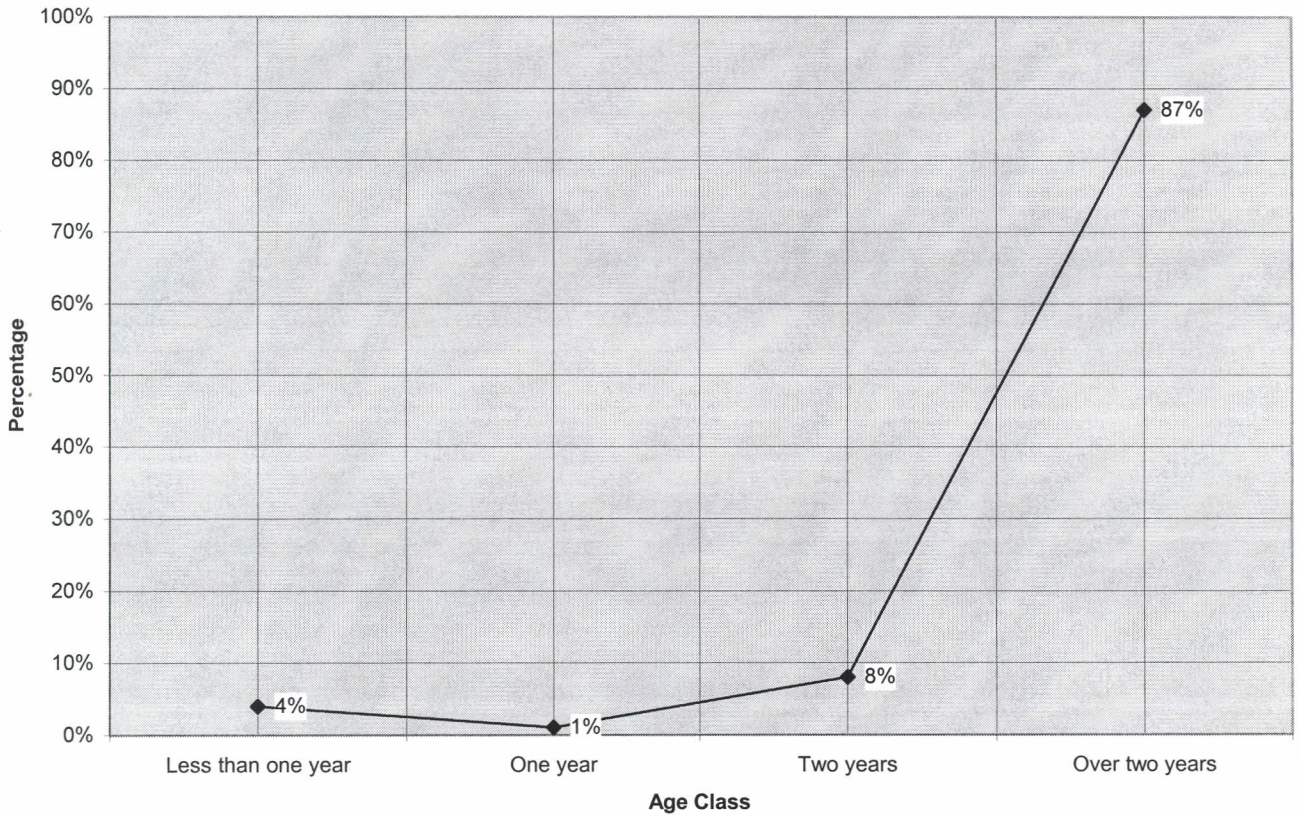
From the above table it can be deduced that most of the SME's were individually owned or are family partnerships, most SME's are closely linked to an individual or a family. They account for 78% of the businesses limited companies were least popular.

Table 4.2: Age of the business

The question was to establish the duration the firm has been in operation. The choices ranged from less than one year to over two years. The results were as below.

Age of the business		
Less than one year	3	4%
One year	1	1%
Two years	6	8%
Over two years	67	87%
Total	77	100%

Age of the Business



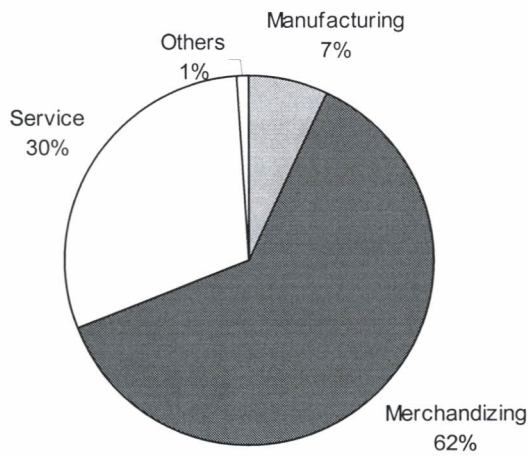
Most businesses have been in existence for over two years (87%). This shows a relative old SME in the municipality. Few start-ups were identified. Only 4% were less than one year.

Table 4.3: Type of activity

To find out the common type of activity, this question offered the choices of manufacturing, merchandizing, service and the option of inserting any other not captured in the choices. The findings were as below.

TYPE	FREQUENCY	PERCENTAGE
Manufacturing	5	7%
Merchandizing(Retail shops)	48	62%
Service	23	30%
Others	1	1%
Total	77	100%

Type of Activity

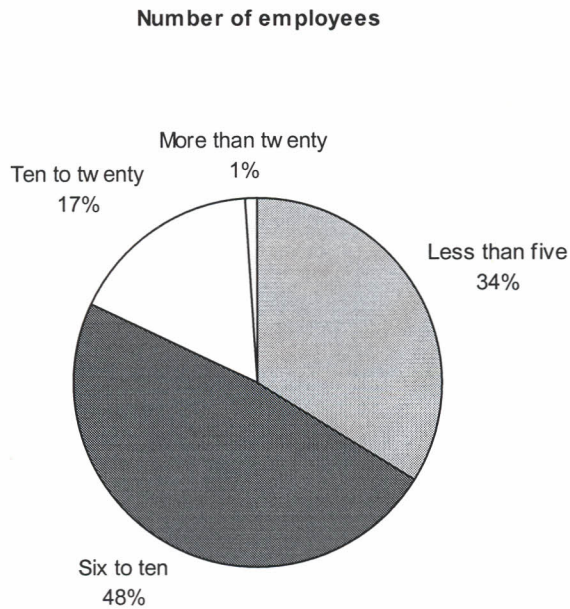


Most businesses are involved in merchandizing activities (buying and selling) at 62% followed by service at 30%. Merchandizing businesses appear to be the easiest to start and operate. Their operations seem fairly easy to grasp.

Table 4.4: Number of employees

The number of employees is an important measure of SMEs, to investigate this the respondents were asked to record the number of employees under their employment. The response was as below.

NUMBER	FREQUENCY	PERCENTAGE
Less than five	26	34%
Six to ten	37	48%
Ten to twenty	13	17%
More than twenty	1	1%
Total	77	100%



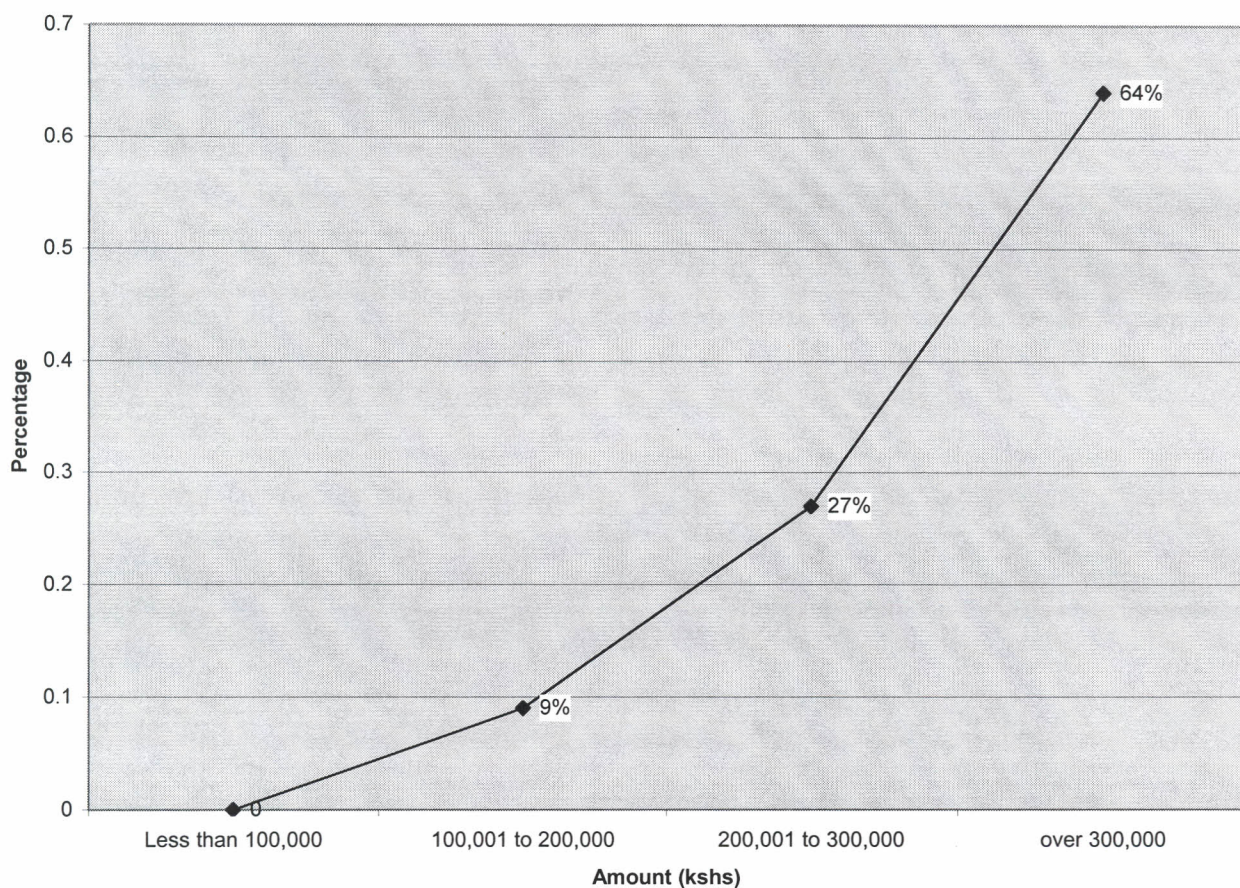
Most SME's employed between six to ten employees at 48% closely followed by SME employing less than 5 employees at 34%, hence SME's in that are basically few people employers, only 1% employed more than twenty people.

Table 4.5: Annual turnover

The annual turnover is a key indicator to SMEs; to determine the annual turnover the respondent were asked to fill in their annual turnover. The options provided ranged from less than Kshs.100000 to over Kshs.300000. The response was as below.

Amount (Kshs)	Frequency	Percentage
Less than 100,000	Nil	Nil
100,0001 to 200,000	7	9%
2000001 to 300000	20	27%
Over 300000	48	64%
	75	100%

Annual Turnover

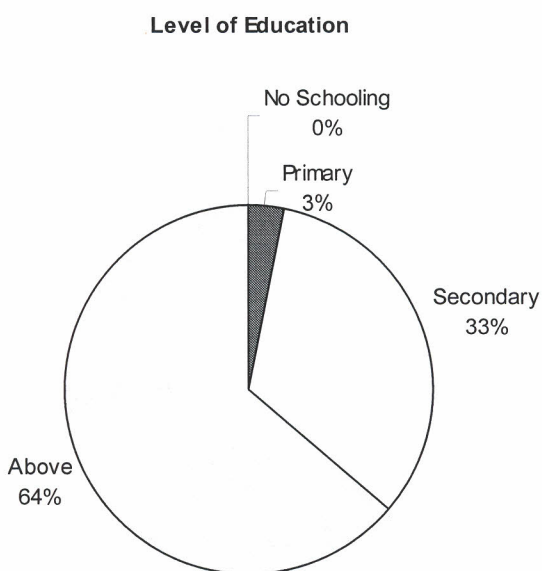


Most SME's turnover was over Kshs.300, 000 at 64%. There was none that responded at less than Kshs.100000. However, 2 respondents declined to disclose their annual turnover, the respondents were not very confident that it would not be used for other purposes. This could be an indication of malpractices in tax returns.

Table 4.6: Level of Education

The level of education of is a key indicator of an individual's exposure, to investigate the level of education, the respondent were asked to fill in their education background, the choices ranged from no school to above secondary education.

Level	Frequency	Percentage
No schooling	-	-
Primary	2	3
Secondary	26	34
Above	<u>49</u>	<u>65</u>
	77	100



Most SME's are being operated by persons whose education level is above secondary schools i.e. college and universities. Only 3% are of primary level and nil with no schooling, 65% hold more than secondary school academic qualifications. The high level of unemployment, where highly educated persons are being unable to secure formal employment, therefore being forced to get into informal sector, could explain this.

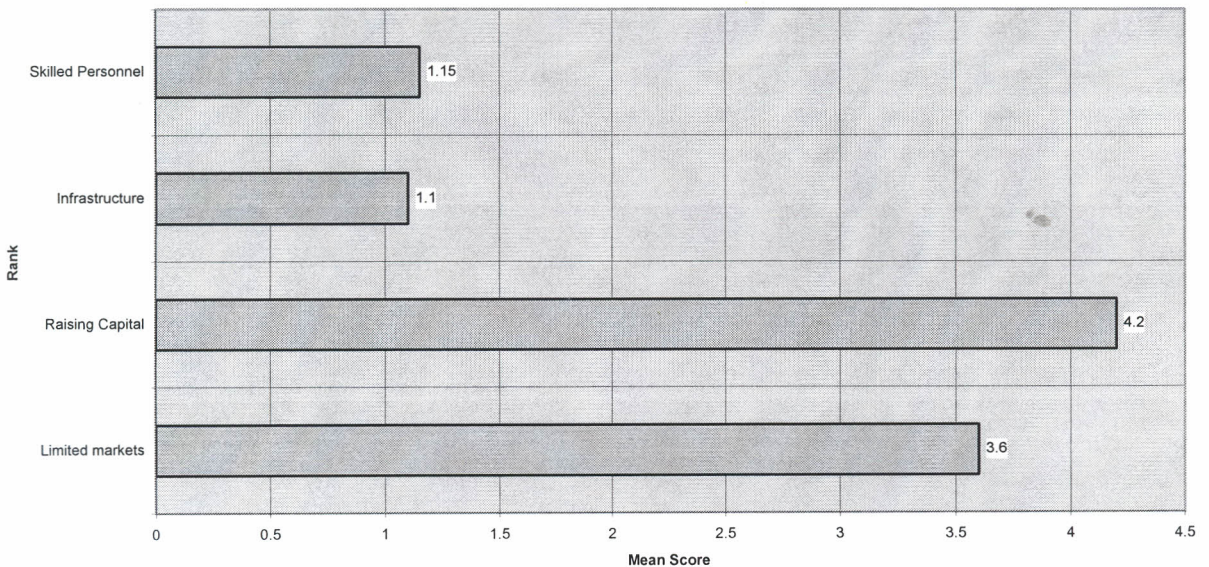
SECTION B

Table 4.7: Significant obstacles to expansion

To identify the perceived obstacles to expansion, the respondent were asked to rank possible obstacles in the order of significance, the options included limited markets, raising capital, infrastructure skilled personnel and the option to include any other limitation, the responses were summarized as below.

Rank	Limited markets	Raising capital	Infrastructure	Skilled personnel	Other
5	24	46	-	-	-
4	30	19	-	1-	-
3	6	2	2	3	-
2	2	2	4	3	-
1	15	8	72	70	-
Mean score	3.60	4.20	1.10	1.15	-
Ranking	2	1	4	3	5

Significant obstacles to expansion



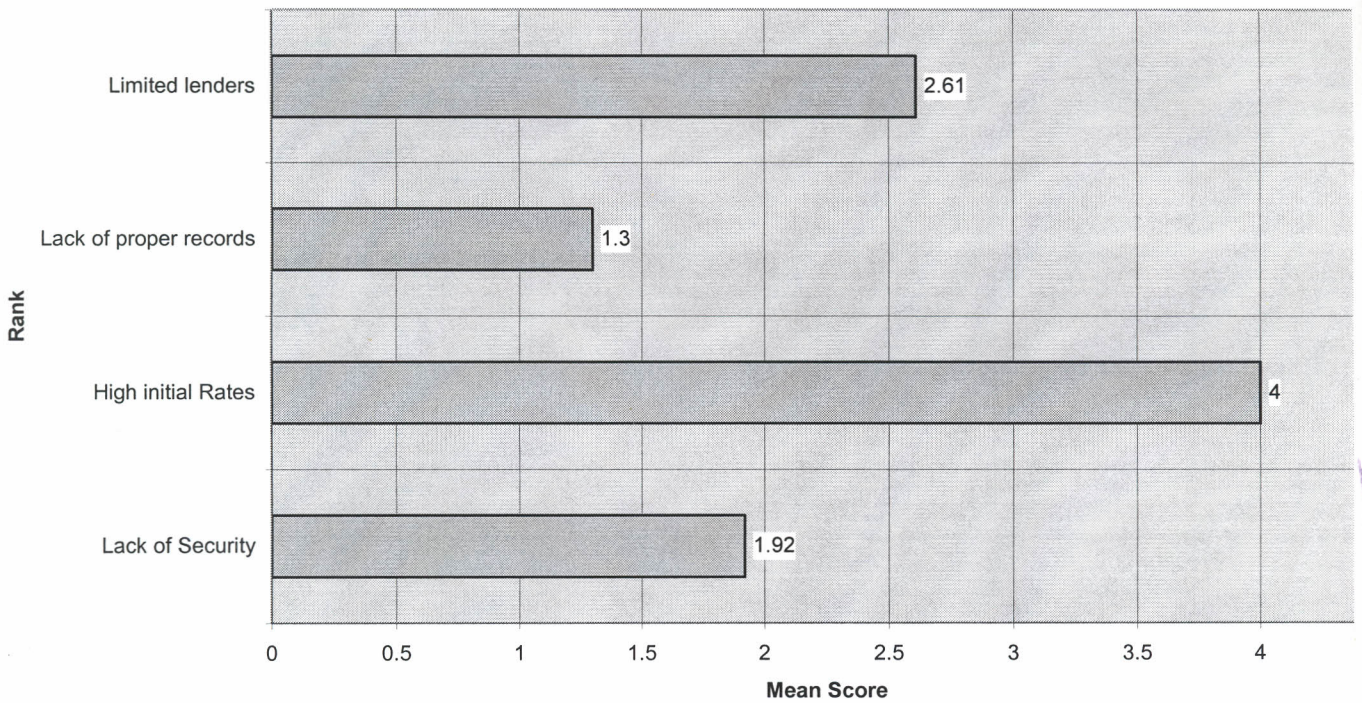
Raising capital is the largest obstacle to business expansion. The average score is 4.2 out of 5.0; limited markets with 3.6 closely follow it. However infrastructure and skilled personnel are not a significant obstacle to business expansion.

Table 4.8: Difficulties in raising finance

To capture the difficulties experienced in raising finance the respondent were asked to rank the possible difficulties in the order of importance, the options given were lack of security, high interest rates, lack of proper records, limited lenders and the option to include any other difficult. The response was as captured below.

Rank	Lack of security	High initial rates	Lack of proper records	Limited lenders	Other
5	14	55	1	4	-
4	1	2	5	32	-
3	3	2	1	5	-
2	6	1	2	2	-
1	53	17	68	34	-
Mean score	1.92	4.0	1.30	2.61	-
Ranking	2	1	4	3	5

Difficulties in raising Finance



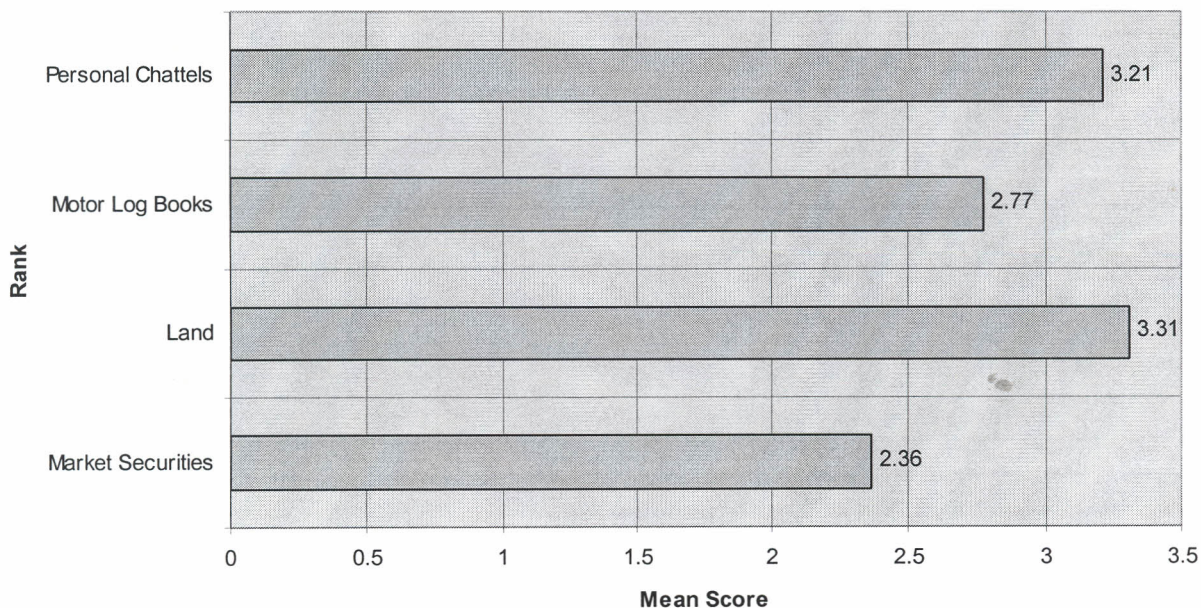
High rates of interest is the difficulty faced when raising finance, the other factors trail far behind. High interest rate have an average ranking of 4.0 the closest factor is limited lenders at 2.6; lack of security is the least important at 1.92.

Table 4.9: Acceptable securities

The financiers asked the respondents about acceptability of the various securities, the options provided for ranking were land, market securities, motor logbooks, personal chattel and the option to include others. The response was as below:

Rank	Market securities	Land	Motor log books	Personal chattels	Other
5	8	34	5	29	-
4	20	6	13	13	-
3	3	2	27	6	-
2	7	20	6	3	-
1	39	15	26	26	-
Mean score	2.36	3.31	2.77	3.21	-
Ranking	4	1	3	2	5

Acceptable Securities



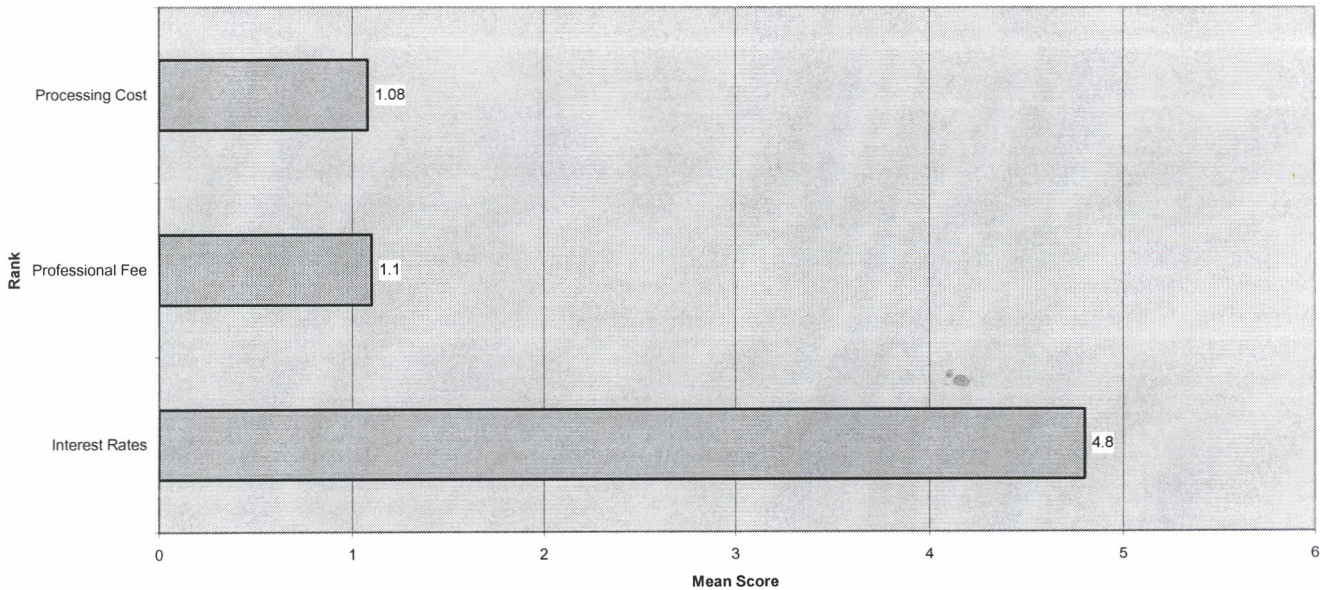
Land and personal chattels are the most readily acceptable forms of securities. Though land is slightly favored the difference is minimal the other two market securities and motor log books are also closely ranked.

5.0 Expensive borrowings costs

To identify the borrowing costs thought to be expensive, the SMES were asked to rank interest rate, professional fees, processing costs and any other costs starting with the most expensive, the results were as below.

Rank	Interest Rates	Professional Fee	Processing Costs	Other
5	73	1	1	-
4	-	-	-	-
3	-	1	1	-
2	-	2	-	-
1	4	73	75	-
Mean score	4.8	1.10	1.08	-
Ranking	1	2	3	4

Expensive Borrowings Costs



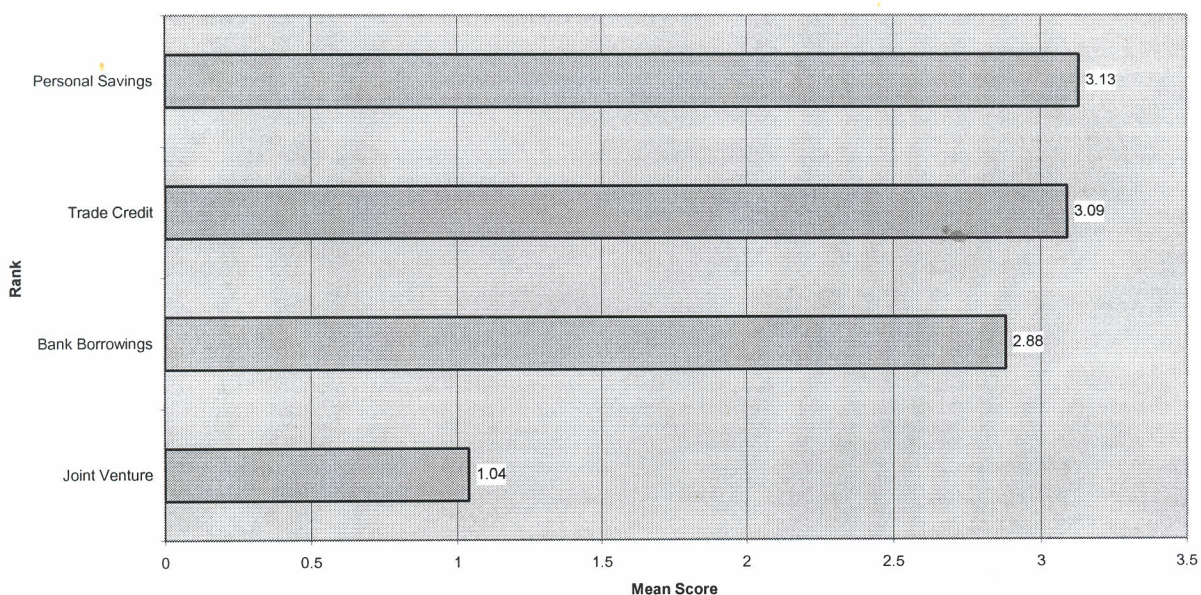
Interest rate is the most expensive borrowing cost averaging at 4.8 all the other two trail far behind indicating they are least important. Most SME's seem to consider the interest rates unaffordable.

Table 5.1 Common sources of capital used

To determine the most commonly used source of capital, the respondents were asked to rank the following sources in the order of commonness-joint venture, bank borrowings, trade credit personal savings and any other. The responses were as below.

Rank	Joint venture	Bank borrowings	Trade credit	Personal savings	Other
5	-	14	26	21	-
4	-	9	20	25	-
3	1	30	1	3	-
2	11	2	1	5	-
1	75	22	23	17	-
Mean score	1.04	2.88	3.09	3.13	-
Ranking	4	3	1	2	-

Common sources of capital used

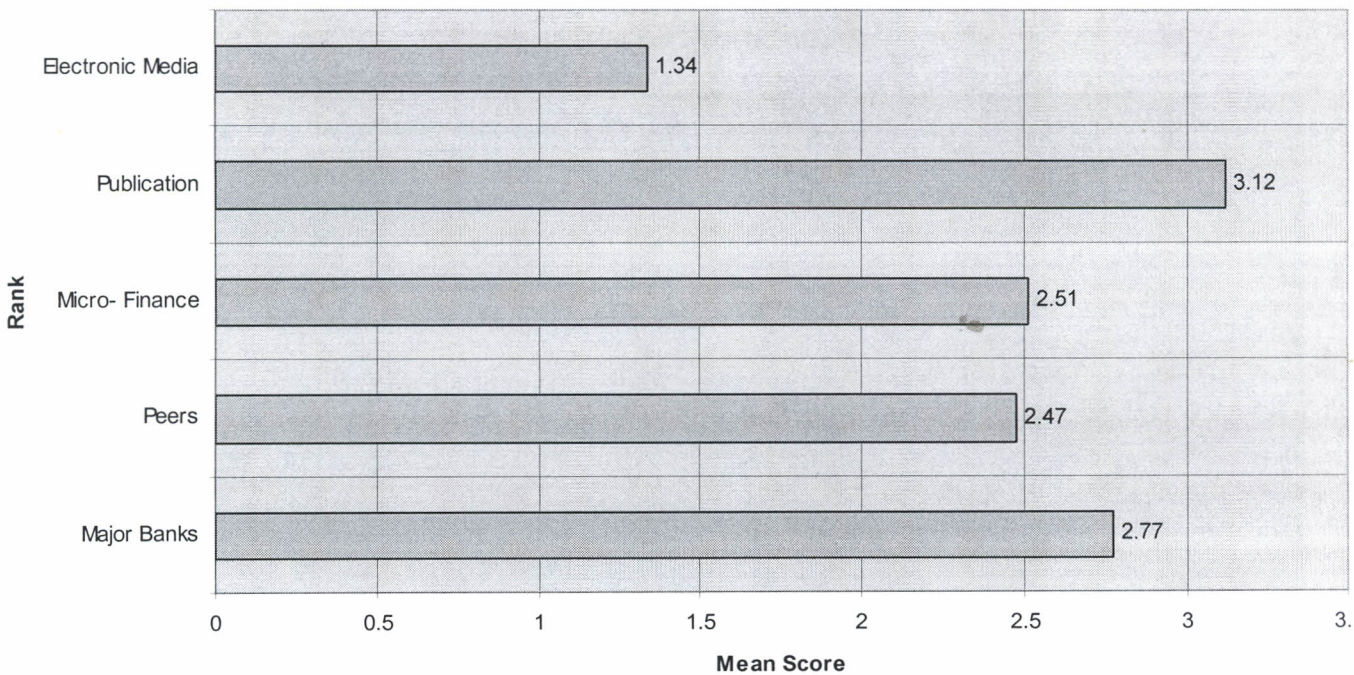


Personal savings and trade credit are the most common source of capital used by SME's. Personal savings are slightly favored, closely followed by trade credit. Bank borrowing plays an important part but joint venture is the least important.

Table 5.2 Major sources of information

Rank	Major banks	Peers	Micro-finance	Publication	Electronic media
5	16	13	19	13	4
4	15	12	6	21	2
3	7	8	10	23	1
2	13	9	2	3	2
1	26	35	40	17	68
Mean score	2.77	2.47	2.51	3.12	1.34
Ranking	2	4	3	1	5

Major Sources of Information



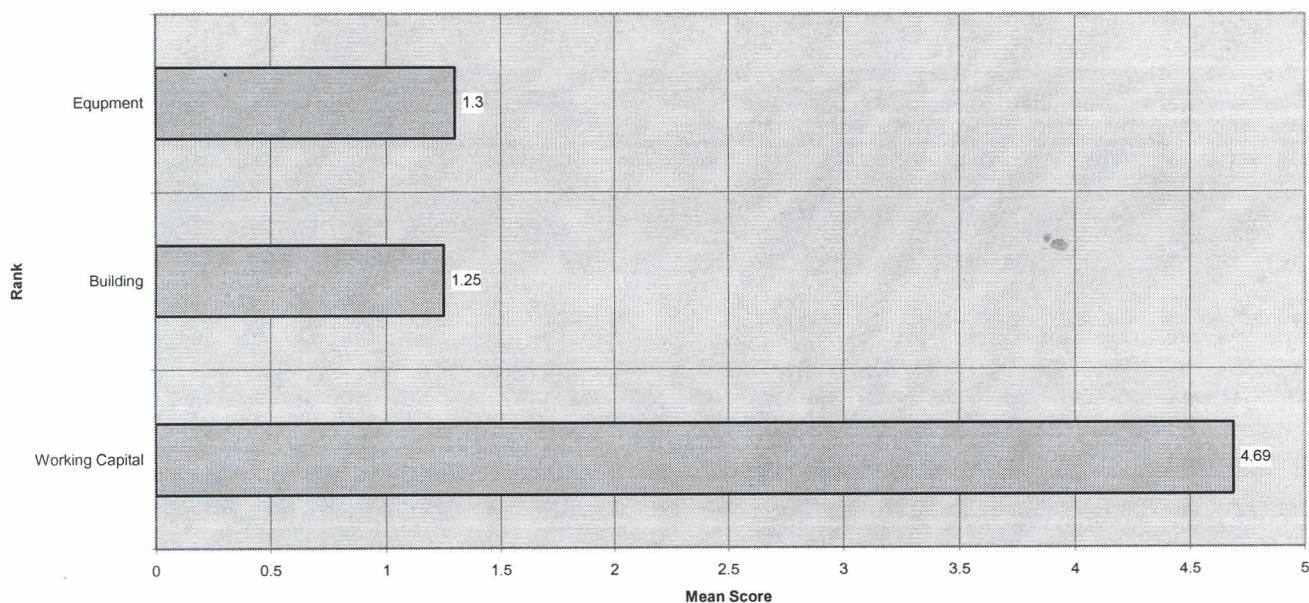
All the sources except the electronic media seem to be very well used. Publications, banks, micro-finance institutions and peers all appear to be playing an almost equal role but slightly favored respectively. Publication seems to be the most favored or used.

Table 5.3 Purpose of the last credit facilities

To identify the purpose the last credit facilities were obtained for, the respondents were asked to rank working capital, building, equipment and any other purpose .The response was as below.

Rank	Working capital	Building	Equipment	Other
5	68	1	3	-
4	4	1	3	-
3	-	1	1	-
2	-	10	-	-
1	5	64	70	-
Mean score	4.69	1.25	1.30	-
Ranking	1	3	2	-

Purpose of the last credit facilities



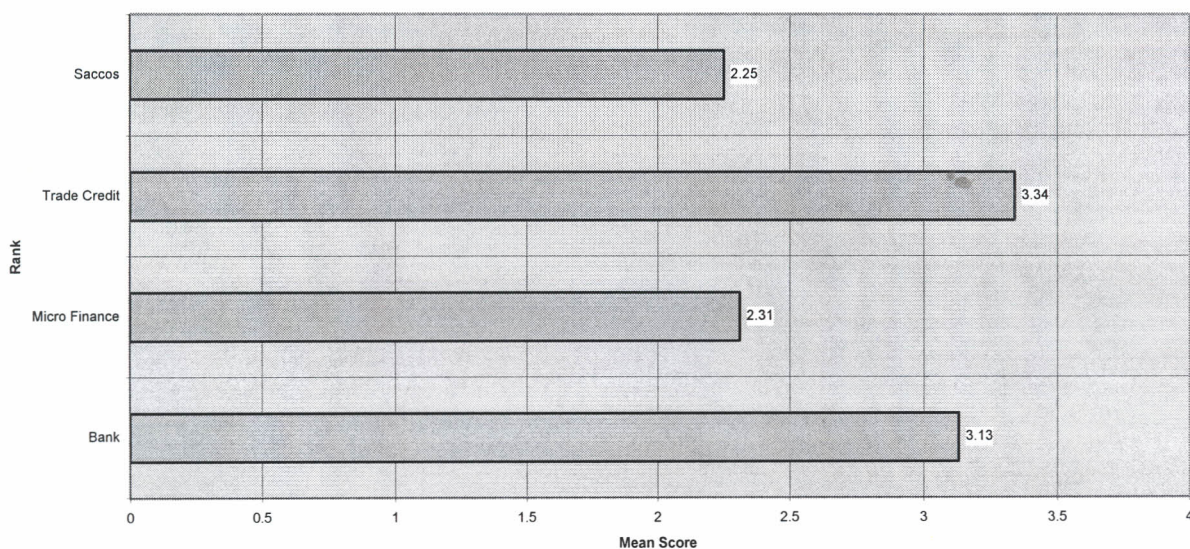
Working capital is the most common reason why most SME borrow for the other reasons hardly feature as important at a rank of maxim 5 the rank attained by working capital was pretty high at 4.69.

Table 5.4 Easiest source of finance

To identify the easiest source of finance, respondent were asked to rank bank loans, micro-finance, trade credit and Saccos. The summary of the responses was as below.

Rank	Bank	Micro finance	Trade credit	Saccos
5	23	9	32	7
4	14	10	14	13
3	8	15	5	11
2	14	5	2	7
1	18	38	24	39
Mean score	3.13	2.31	3.34	2.25
Ranking	2	3	1	4

Easiest source of Finance



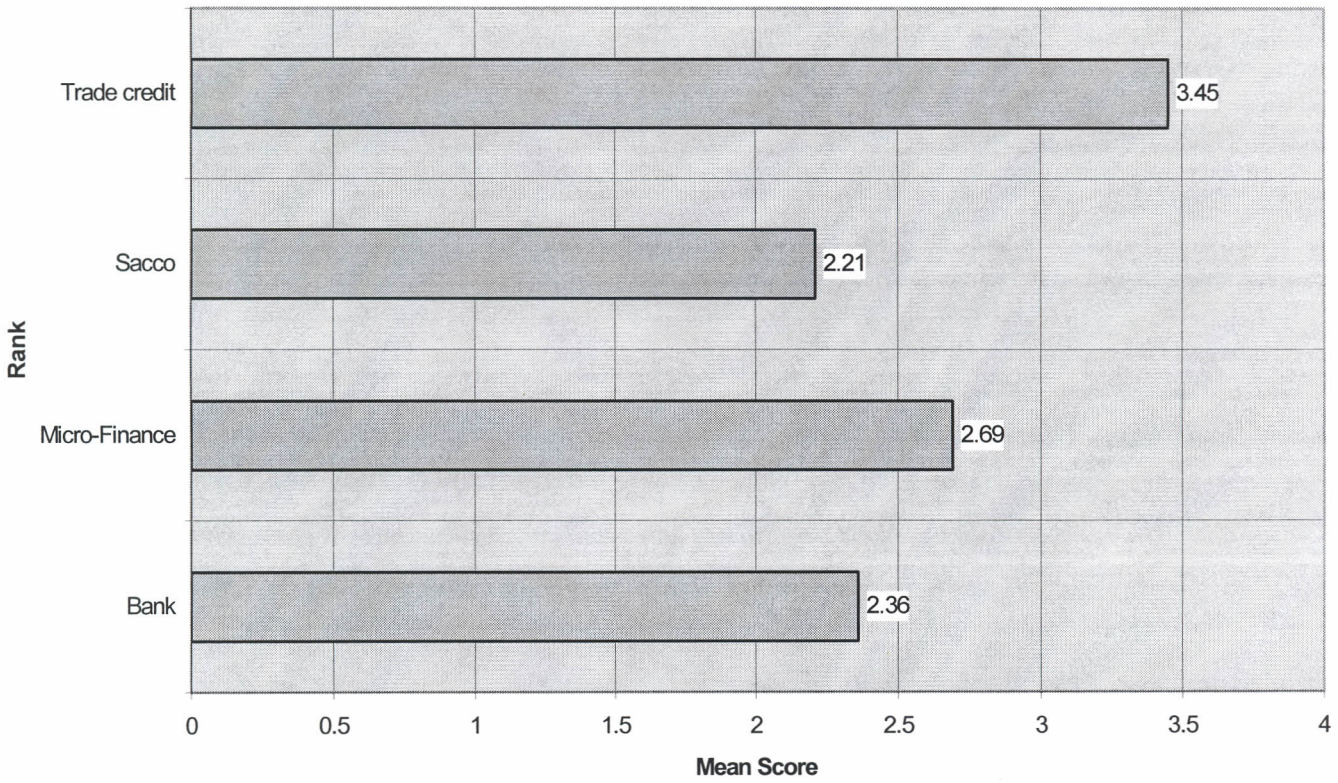
Trade credit and banks are the easiest sources of finance ranking very close to each other although, trade credit is the easiest, micro finance and Saccos do not seem to be easy to access, they were closely ranked.

Table 5.5 Most favorable sources in terms of costs

The respondents were asked to rank the most favorable sources of finance in terms of costs; their responses were summarized as below.

Rank	Bank	Micro finance	Sacco	Trade credit
5	12	12	3	41
4	7	18	14	7
3	5	8	18	5
2	26	6	3	-
1	27	33	39	18
Mean score	2.36	2.69	2.21	3.45

Most Favorable sources in terms of costs



Trade credit consistently seems to be more favored in terms of costs and accessibility. Saccos and banks seem to trail, micro finance comes second

CHAPTER FIVE

5.0 CONCLUSIONS

The objectives of the study were:

- ✓ Establish the practical problems faced by SME's in raising capital.
- ✓ Establish the main sources of information SME's use on sources of capital.
- ✓ Establish the most common sources of finance to SME's.

5.1. SUMMARY OF THE ANALYSIS

Out of the 77 respondents 46 ranked raising finance as the biggest obstacle to business expansion. It ranked first after obtaining the mean. Other problems limited market; skilled personnel and infrastructure were not very significant.

Out of the 77 respondents 55 ranked high interest rates as the biggest difficulty. The mean stood at 4.0. The other difficulties limited lenders lack of security, and lack of proper records were not apparently great difficulties. Their mean ranking was fairly low.

Out of the 77 respondents 73 ranked the interest rates as the most expensive costs. It scored a mean of 4.8 out of 5 confirming the fact that this is seen as prohibitive.

Out of the 77 respondents 13 respondents ranked publication (Newspapers and Magazines) as the most common while 19 ranked micro-finance as the most common, however the mean ranking indicated that publications were the most common source of information with a mean of 3.12, followed by banks with a mean of 2.77. Electronic media was least used with a mean of 1.34 ranking last.

Personal savings were ranked as the most common sources of finance closely followed by trade credit. 26 respondents ranked trade credit as the most common source whereas 21 ranked personal savings as the most common. However on obtaining the mean score, personal savings

obtained 3.13 and trade credit 3.09, indicating the two to be closely popular. Joint venture was least common with an average score of 1.04, bank borrowings closely followed the other two with an average score of 2.88.

Trade credit was ranked as the easiest to obtain closely followed by banks at a mean of 3.34 for trade credit and 3.13 for banks. This is a confirmation of the commonness of the two sources.

However, in terms of costs the SMEs ranked trade credit as the least expensive closely followed by micro-finance at average scores of 3.45 and 2.69 respectively. Banks and SACCOs ranked at 2.36 and 2.21 respectively.

5.2 CONCLUSIONS.

From the study it is evident that raising capital is the biggest obstacle to business expansion. The greatest difficulty in raising finance was ranked as the high interest charged, which was also perceived as the most expensive borrowing cost. Trade credit is the most favored form of raising finance closely followed by banks. The SMEs in Thika town seem not quite familiar with the other forms of raising finance.

Publications (daily newspapers and common magazines) and banks were ranked as the most commonly used sources of information.

Land & Personnel chattels seemed to be the most common forms of securities easily acceptable, though closely followed motor log books and market securities.

5.3 RECOMMENDATIONS

Raising finance is a big issue for the SMEs. The SMEs can benefit a lot from educational workshops and seminars on the various ways and means of raising finance.

It would also be very helpful for the SMEs owners to be trained to look at the business environment from a broader perspective, where provision and obtaining of information can become easier for the benefit of all parties.

The micro-finance institutions that are largely targeting the SMEs can be able to do more business by increasing their presence in the business grassroots. Most SMEs owners viewed borrowing suspiciously.

The Government, through Ministry of Trade or any other appropriate Government Departments, can put in place more advisory centers to help in all aspects of SMEs operations.

5.4 LIMITATIONS OF THE STUDY

The population is from the same town, hence the results may be only applicable to Thika Town, hence cannot be generalized in the whole country.

It would have been more appropriate to apply the questionnaire on all the SME's in the town but the time and financial limitations could not allow.

Lack of co-operation from some respondents reduced the sample size.

Suspicious from some respondents could have lead to distorted information.

5.5 SUGGESTIONS FOR FURTHER STUDIES

From the findings of this study and the limitations identified, the following are suggested areas of further studies: -

Similar study should be undertaken to determine other problems faced by SME's within the municipalities

Similar study should be undertaken on larger business enterprises to determine similarities and difference in the problems faced in raising finance.

Similar study should be conducted in other towns in the country to determine similarities and differences in the problems faced in raising finance.

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5.5 APPENDIX I

5.5.1 SURVEY QUESTIONNAIRE

This study aims at identifying the practical problems faced by small and medium enterprises in raising finance.

All information will be treated as confidential. No information will be released to anyone other than being used for this study.

Your co-operation is highly appreciated: -

Activity:-

Name of firm: -

Form of ownership: -

Contact person: -

1. How long has the firm been in operation?

Less than one year one year

Two years Over two years

2. What is the type of activity of the firm?

Manufacturing Merchandising

Service Other specify

3. How many employees does the firm have?

Less than five Six to ten

Ten to twenty More than twenty

4. What is the average sales annual turnover?

Less than one hundred thousand

- One hundred thousand and one to two hundred thousand
- Two hundred thousand and one to three hundred
Thousand and one
- Over three hundred thousand
5. What the nature of ownership of business/
- Sole Proprietor
- Family partnership
- Non-family partnership
- Others- specify
6. If sole entrepreneur what is the level of education?
- No schooling Primary
- Secondary Above

SECTION B

Rank the items in question in order of importance, most important assigned 5, least important assigned 1

1. What is the firm's most significant obstacle to expansion?
- Limited Market Raising Capital
- Infrastructure Skilled personnel
- Others- specify
2. What are the difficulties faced in raising finance?
- Lack of Security High interest rates
- Lack of proper records Limited Lenders
- Others- specify.....
3. What securities are readily acceptable by the available lenders?
- Market securities Land
- Motor log books Personal chattel

Other – Specify ()

4. What are the most expensive borrowing costs?

Interest rates () Processing cost ()

Professional fee ()

Others – specify..... ()

5. What are the common sources of capital used?

Joint venture () Bank borrowing ()

Trade credits () Personal savings ()

Others – specify..... ()

6. What are the major sources of information of the sources of capital?

Banks () Peers ()

Macro-finance institutions () Publications ()

Economic Media ()

7. For what purpose was the last credit facilities intended?

Working capital () Building ()

Equipment ()

Others – Specify..... ()

8. Which is the easiest source of finance?

Bank () Micro-finance ()

Trade Credit () Saccos ()

Others – Specify..... ()

9. Which source is most favorable in terms of cost?

Bank () Micro-finance ()

SACCO () Trade Credit ()

Others (Specify) ()

APPENDIX II

5.5.2 PROJECT PLAN

Phase	Description	Weeks
1.	Pilot study	1
2.	Adjustments	1
3.	Proposals writing	2
4.	Data collection	3
5.	Data coding	1
6.	Data analysis	1
7.	Report writing	2
8.	Compilation	1
	Total	12

APPENDIX III

5.5.3 Time-Table of events

Phase	Description	Number of weeks											
		1	2	3	4	5	6	7	8	9	10	11	12
I	Pilot study 1 week												
II	Adjustments 1 week												
III	Proposal Writing 2 weeks												
IV	Data Collection 3 weeks												
V	Data Coding 1 week												
VI	Data analysis 1 week												
VII	Report writing 2 weeks												
VIII	Compilation 1 week												