

**EFFECTS OF INTEREST RATES ON THE GROWTH OF SMALL BUSINESS
ENTERPRISES: A CASE STUDY OF SMALL BUSINESS ENTERPRISES
WITHIN KERICHO COUNTY.**

BY: BENSON KIPROTICH KIKWAI

REG NO: D53/KER/PT/24531/2010

**A RESEARCH PROJECT SUBMITTED TO DEPARTMENT OF BUSINESS
SCHOOL OF BUSINESS ADMINISTRATION IN PARTIAL FULFILLMENT
FOR THE REQUIREMENT IN MASTER OF BUSINESS ADMINISTRATION
(ENTERPRENEUR OPTION) OF THE KENYATTA UNIVERSITY**

AUGUST 2013

DECLARATION

This research project is my original work and has not been presented to any other examination body. No part of this research should be produced without my consent or that of Kenyatta University.

Signature.....

Date.....17-10-2013

KIKWAI BENSON KIPROTICH

D53 / KER / PT / 24531 / 2010

This research project has been submitted for examination with my approval as the Supervisor

Signature.....

Date.....17-10-2013

Dr. Yusuf Kibet

Supervisor

Department of Business Administration

Kenyatta University

This research project has been submitted for examination with my approval as the Chairman of the Department.

Signature.....

Date.....17/10/13

Muathe SNA (Phd)

Chairman

Department of Business Administration

Kenyatta University

DEDICATION

This project is dedicated to my wife, Jane Kikwai and kids; Edith, Joan, Tracy, Ishmael and Linda and their uncle Mr. Evans Rotich, Elisha and Leakey. They have been a source of inspiration to me. It is also dedicated to my mum Mrs. Cheruiyot for her motivation, and finally my employer, NHIF for their support.

ACKNOWLEDGEMENT

I wish to acknowledge the affectionate love from the almighty God for giving me health throughout my college studies. I would also like to express my sincere gratitude to my parents who paid for my education. God bless them.

In a special way my appreciation goes to my supervisor who guided me through this research process to complete my project work at the right time and all my lectures Kericho Campus, May the Lord bless you all.

DEFINITION OF THE TERMS

Small (Manufacturing) Enterprises: Enterprise engaged in the manufacture/production or preservation of goods and whose investment in plant and machinery (original cost excluding land and building and the items specified by the Ministry of Small Scale Industries vide its notification.

Small (Service) Enterprises: Enterprise engaged in the providing/rendering of services and whose investment in equipment (original cost excluding land and building and furniture, fittings and other not directly related to the service rendered or as may be under the Micro, Small and Enterprises Development (MSMED) Act.

Micro (Manufacturing) Enterprises: Enterprise engaged in the manufacture/production or preservation of goods and whose investment in plant and machinery (original cost excluding land and building)

Micro (Service) Enterprises: Enterprise engaged in the providing/rendering of services and whose investment in equipment (original cost excluding land and building and furniture, fittings amongst others)

TABLE OF CONTENTS

DECLARATION	ii
ACKNOWLEDGEMENT	iv
TABLE OF CONTENTS	vi
ABSTRACT	viii
CHAPTER ONE	1
INTRODUCTION	1
1.0 Overview	1
1.1 Background of the study	1
1.2 Statement of the problem.....	3
1.3 General objective	4
1.3.1 Specific objectives	4
1.4 Research questions	4
1.5 Significance of the study.....	4
1.6 Limitations of the study	5
1.7 Scope of the study	5
CHAPTER TWO	6
LITERATURE REVIEW	6
2.0 Overview	6
2.1 Introduction	6
2.2 Theoretical Review	7
2.2.1 Effects of interest rates on small enterprises.....	7
2.2.2 Banks credit management problems.....	9
2.2.3 Inefficient institutional infrastructure.....	14
2.4 Conceptual Framework	18
Value added tax	18
Growth of small enterprises.....	18
CHAPTER THREE.....	20
RESEARCH DESIGN AND METHODOLOGY	20
3.0 Overview	20
3.1 Research design.....	20
3.3 Target population	20
3.4 Sample size determination	20
3.4 Data Collection Instruments and Procedures	21
3.5 Validity of Research Instruments	22
3.6 Reliability	22
3.7 Data analysis and presentation.....	22
CHAPTER FOUR	23

DATA ANALYSIS, PRESENTATIONS AND INTERPRETATION OF THE FINDINGS.....	23
4.1 Introduction	23
4.2 Presentations	23
4.2.1 Gender of the respondents	23
4.2.2 Age bracket	24
4.2.3 Level of education.....	25
4.2.4 Duration of service in business	26
4.2.5 Response to interest rates.....	27
4.2.6 Extent of interest rates	27
4.2.7 Repayment terms	28
4.2.8 Credit Management.....	28
4.2.9 Instability.....	29
4.2.10 Institutional infrastructure.....	30
CHAPTER FIVE	32
SUMMARIES OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS	32
5.0 Introduction	32
5.1 Summaries of the findings	32
5.2 Conclusions.....	34
5.3 Recommendations.....	36
5.4 Suggestions for further studies.....	36
REFERENCE.....	37
QUESTIONNAIRE	39
COVER LETTER.....	42

ABSTRACT

Small businesses operate under harsh conditions and are not able to help spur required high economic growth. Some of the key challenges to majority of small business is lack of adequate and affordable credit and thus upset their desired growth. The small sector contributes immensely to the growth of the economy but there is little facilitation in terms of enacting a sound legal framework and increase resource allocation. This research therefore aimed at establishing the effects of interest rates on the growth of small enterprises. The study was guided by the following objectives; To determine the effect of interest rates fluctuation on the growth of small enterprises, to evaluate the effect of taxation on the growth of small enterprises and to establish the effect of credit repayment terms on the growth of small enterprises. A descriptive research design was used with a target population of 1500 respondents of which 306 of them were sampled. Questionnaires were used for data collection. The validity of the instruments used was achieved by discussing the relevance of the research instruments with the supervisor to ensure simple and accurate questions provide simple answers. Reliability was achieved by pre-testing the same data in Kericho County. The findings showed that small enterprises have suffered greatly due to high interest rates levied upon them by financial lending institutions. High interest rates are caused by high economy due to inflation, the drop in Kenyan shilling and high taxation on basic commodities by the government. Conclusions are that there is high exposure to risks which include; theft, fraud, destructions by fire among others. Banks faces risks in trying to collect the amount loaned to these small scale enterprises. However, small enterprises are majorly affected by inflexibility of their operations.

Recommendations are Small entrepreneurs are encouraged to do marketing activities outside the County, and adopt new skills of doing business through computer aided techniques. To mitigate risks, they are advised to insure the business premise. Majority of small enterprises has collapse, therefore they are dormant, and this has affected the operations of other businesses since their existence impact on the growth of other small enterprises in order to ensure competitive environment is ensured. The government through ministry of finance should regulate policies aimed at regulating the fluctuations of interest rates by banks because this has impacted negatively to the growth of small enterprises.

CHAPTER ONE

INTRODUCTION

1.0 Overview

This chapter presents the background of the study, the statement of the problem, objectives of the study, research questions; its significance, the limitations of the study and the scope of the study.

1.1 Background of the study.

In the recent past few years, many small enterprises in the world have been striving to achieve their best in terms of profit maximization and capital flexibility to ensure that they meet the best level of performance in their operations. (Ngugi W.2000) This has been attributed and made possible by falling interest rates from financial institutions and favorable interest rates. The need for small enterprises to access affordable capital for growth and expansion is not the only reason behind the Nairobi's stock exchange initiative. Creation of the small board however, will make the operations of these entrepreneurs worth beneficial by discussing the essences of lending rates with financial institutions; this will establish a graduation platform to the main market besides providing a wide range of investment opportunities in the economy to private and corporate investors. It may be warned that, taxation targeting investors could negate the effects of the small enterprise exchange. It is however known that, money lending small enterprises through private placement to raise capital through capital market products. According to UCO bank in India, throughout the World, the Micro and Small Enterprises (MSEs) have been accepted as the engine of economic growth and for promoting equitable development. In India too, the MSEs play a pivotal role in the overall industrial economy of the country. It is estimated that in terms of value, the sector accounts for about 39% of the manufacturing output and around 33% of the total export of the country. Further, in recent years the MSE sector has consistently registered higher growth rate compared to the overall industrial sector. The major advantage of the sector is its employment potential at low capital cost.

The Government of India has been making concerted efforts for the promotion and development of MSE sector which enabled the MSE sector to grow at a higher pace than the overall industrial sector. To facilitate the development of this sector as also enhanced their competitiveness, the Government has enacted the Micro, Small and Enterprises Development (MSMED) Act, 2006, which is in force from 2nd October, 2006 which is a turning point for the development of Indian Industry, as it addresses and streamlines entire framework along with key governance & operational issues being faced by the SMEs.

Jordan M. (2010) the biggest challenges for private placement in Kenya have been in existence for investors. Moreover, most small enterprises are yet to appreciate the services of professionals like investment bankers and are unwilling to pay the high fees that come with such services. The essence in this issue shows that interest rates levied by the supporting agencies in terms of monetary are huge and heavy for the up-coming small enterprises or for the progressing entrepreneurs. Therefore small enterprises need to be trained on proper record preparation, keeping and interest controls; this will enable them to benefit from capital markets. Furthermore, Jordan M (2010) explains that small enterprises require the government to amend company act, in order to recognize the unique nature of small enterprises and development of guidelines to ensure that business are run ethically and sustainability. For successful establishment of such a market, an enabling regulatory framework and environment which include cheaper cost of capital, capacity building, succession from family to corporate, professional management will be required. By so doing small enterprises owners will not fill huge pressure levied to them by money lending institution due to their interest rates charged. One of the major policy initiatives of the Government has been inclusion of the MSE sector under priority sector lending. It has been done because credit is one of the critical inputs for the sustained growth of the MSE sector. The MSE sector has been receiving direct assistance from the commercial banks mostly for meeting working capital requirements. The slow growth in business expansion of small enterprises has been attributed to rising interest rates in financial lending institutions.

1.2 Statement of the problem

Many organizations today, particularly small enterprises are facing a lot of problems. These challenges have hindered them in developing their own business. (Rose 2000). These factors include; high and costly interest rates amongst others such as expensive site location depending on the type of businesses, frauds due to poor management and embezzlement of funds, lack of enough skills to manage the business and lack of enough funds. It is due to inability to gather enough capital for the business, these has rendered them to seek solace in financial lending institutions. The process of seeking for loan facility, heavy interest rates have been given to them of which failure to summit the granted amount, will lead to heavy penalties on them. (Jordan M. 2010) Despite, constant operations and competition by small enterprises, its slow growth has been attributed by rising interest rates from the financial lending institutions, this has occurred mainly due to inflation, the drop in shilling and the high taxation by the government. In most cases, interest rates have impacted negatively on the growth of small enterprises. Therefore, small enterprises are unable to pay the high interests that come with such services. The essence on this issue shows that interest rates levied by the supporting agencies in terms of monetary solutions are huge and heavy for the growing enterprises and this may slow or even decline their growth, so small enterprises need to be trained to outsource other ways of making capital through competitive market penetration, proper record keeping, internal control and forecasts on the outflows and inflows and the future market demand so as to give them proper preparation on decision making, hence will benefit from capital markets. (Jordan M. 2010) Therefore this gap is worth studying to provide solutions to unresolved issues that affect interest rate on the growth of small enterprises and evaluate its positive effects to a long term solutions to the current challenges.

1.3 General objective

The general aim of the study was to establish the effects of interest rates on the growth of small enterprises in Kenya.

1.3.1 Specific objectives

- a) To determine the effect of interest rates fluctuation on the growth of small enterprises
- b) To determine the effect of Value Added Tax on the growth of small enterprises
- c) To determine the influence of collateral on the growth of small enterprises

1.4 Research questions

- a) What is the effect of interest rate fluctuation on the growth of small enterprises?
- b) What are the effects of Value Added Tax on the growth of small enterprises?
- c) What is the effect of collateral on the growth of small enterprises?

1.5 Significance of the study

The findings is used to address current challenges that affect the small enterprises; such findings will however provide both short and long term solutions. Short term solutions to the unresolved issues of interest rate that are clearly defined to be hindering the rapid growth, and long-term solutions is presented to fill the gaps that may provide permanent damage to the business like collapse, and thus is of great significance to present the tools used in forecasting future demands of the enterprise as it grows gradually.

To the community: The surrounding community will benefit at all cost, provides immediate solution to their demands by honoring the demand of service or goods required. The distance sourcing of materials by the community will have been made easy by bringing them near, because there enterprises source the goods from far and supplying them with favorable prices within. The enterprises will also recruit the locals, thereby improving on their living standards.

To the government: in that, the enterprises will be in a position to pay taxes to the government because of its improved performance. This will generate revenues which will be used in other sectors of the economy in this county. Since the local community will have benefited, the living standards of people will have improved which was one of the aim of the government hence economic status will have improved.

Financial Institution

This will benefit financial institutions since it will address the challenges that face them.

1.6 Limitations of the study

The study was limited to small business enterprises in Kericho County.

1.7 Scope of the study

This study was done in Kericho County, south of Great Rift Valley province. It was done in the month of March to October 2013 with a target population of 1500 respondents of small enterprises of which 306 respondents were sampled. This include: owners, management and employees.

CHAPTER TWO

LITERATURE REVIEW

2.0 Overview

This chapter presents the literature of the past research studies done on the related field, it also highlights the theoretical framework.

2.1 Introduction

Interest rates can be defined as the premium received by the lender after a stated period of time. From the borrower's point of view, it is the cost of capital at the time of obtaining a loan. There are several schools of thought regarding the interest rates. (Classical journal March 2000), the rate of interest is the main determinant of savings and investment. This school asserted that aggregate investment is inversely related to the rate of interest. This relationship has been observed to a weak one; that is, investment tends to be fairly interest-inelastic because it is influenced by businessmen's expectations, and yields are normally estimated within a particular range, so if a small increase in the interest rate occurs, it will not disturb the long-run expansion of the enterprises. The Neo-Classical school maintains that the interest rate is determined by supply (savings) and demand (marginal efficiency of capital). Autonomous increase in savings reduces the interest rate and the additional cost of capital. Because additional investment contributes to diminishing returns, this will cause a 'switch' from less capital-intensive to more capital-intensive methods of production. The phenomenon of re-switching has led to the two Cambridges' controversy of capital theory (Hardwick,1990). Keynes believed that the quantity of money played a key role in determining the rate of interest. Hoff (1990) viewed the equilibrium interest rate as that rate which equates the supply of money with the demand for money. The equilibrium rate of interest is determined by factors affecting the supply of money and the money demand.

2.2 Theoretical Review

The modern view of interest rates is based on the imperfect information paradigm. Stiglitz (2000). Small and enterprises are affected by interest rates in the same way larger businesses are. There is, however, one central distinction: smaller firms are usually more vulnerable than larger ones. The main risk factor for smaller-firm loans is the fact that these businesses have less stability and less capital on hand to cushion any risk. Walter J. (2011)

The classical theory on the effect of interest rates on small enterprises by Funkor showed that, operational interest rate in the context of the demand for credit by the SME's shows the interplay of several factors. Some of these factors include high inflation, cost of intermediation, high credit risk, exchange rates, high bank rate and high Treasury bill rates. Funkor (2000), the average Ghanaian business operator in the private sector, views interest rate as a measure of the price paid by a borrower to a lender for the use of financial resources for a time interval. This research views interest rate as the cost of borrowing money within a stated period.

Before 1988, interest rates were administratively set by the Bank of Ghana (BoG). The financial sector suffered from the distorted macroeconomic policies and deteriorated greatly. Cheap credit was directed to the favored borrowers, mostly the public sector, at the expense of economic efficiency and productive investment. As a result, financial intermediation in the economy declined.

2.2.1 Effects of interest rates on small enterprises

a) Financial Instability

According to Njuguna S.(2000), Interest rates did not follow the theoretical expectations either in level or spread. There was a modest increase initially, and when the interest rates rose and were positive in real terms they were also very high, an indication of financial distress and instability. Therefore, the period following interest rate liberalization was characterized by macroeconomic and financial instability. There were also attempts at institutional reforms in the financial and other sectors. The

reform process, however, failed in several respects to meet preconditions/prerequisites for successfully financial reform. In addition, the period was characterized by diminishing policy credibility, especially with conflicting policy signals emanating from the monetary and fiscal authorities. This created uncertainty in the market, for example, with inflationary expectations. Survey shows that market fundamentals and institutional impediments influence interest rate spread. The empirical results show that:

Disequilibrium in the loans market is a major factor that propels the widening of interest rate spread. The situation is mainly explained by the availability of deposit resources, the alternative investment channels for banks and the ease of portfolio adjustment at the end of the period.

Institution constraints, market micro-structures and policy actions explain substantial variations in interest rate spread. This is because of their impact on the transaction costs and a compounding effect from risk and uncertainty in the market.

Performance in the loans market reflects the macroeconomic environment where macroeconomic stability serves to reduce the risk premium and ensure positive returns for investment, reducing the credit risks. It also reflects the moral-hazard and adverse-selection charge high interest rates on the performing loans.

The impact was felt more with economic shocks, when there was no hedging of such risky loans by a well-diversified portfolio, and if investment in information capital, especially to cater for adequate analysis in monitoring and evaluation of funded projects, is yet to be carried out. On the other hand, if the inter-bank market is not well developed and there are restrictions on the discount window, banks will face a tight liquidity situation. If this is coupled with high reserve requirements, the banks' stability will be threatened. In addition, the presence of implicit or explicit insurance promotes adverse selection and moral hazard problems, and as capital controls are relaxed, banks are exposed to foreign exchange risk.

Interest rates are, under most circumstances, economic signals. If rates are low, the signal to the business world is that economic times are good, and it is a good time to

invest. Higher rates are a sign of slowing growth and normally serve to contract borrower enthusiasm. Because smaller firms are normally more vulnerable to market fluctuations, interest rates have a sharper effect on these firms. A small hike in rates can mean life or death for a small business.

b) **Macroeconomic Issues**

Interest rates are macroeconomic indicators that have microeconomic effects. The main issue is that higher rates make money more expensive. Many smaller businesses, especially start-ups, are extremely risky because their profit margins are razor thin, if they exist at all. Big companies can use their immense resources to undersell and undercut their smaller business competition. Big corporations can put pressure on suppliers and labour to keep costs low, and banks are far more willing to take a risk with them than with the small store down the street. Interest rate increases, in other words, have a greater effect on smaller business than their larger competitors because the latter can lean on far greater resources to deal with any rate hikes. Banks do not care about saving small business, but about reducing risk. This means they place their money with the larger firms. Ngugi W,(2000) macroeconomics, under these circumstances, if a company finances a project out of pocket, it pays, in an opportunity cost sense, an implicit interest rate of prime-minus-one. However, if it has to finance it through a bank, it pays an interest rate 8 or 9 percentage points higher. Thus a lot of projects that would be profitable, if financed internally, will have low-or-negative returns-on-investment if financed through a bank. Allowing small businesses to keep more of their money will increase the number of profitable investment opportunities they have, so the story of higher economic growth from the income effect of lower businesses taxes appears to have a great deal of merit

2.2.2 Banks credit management problems

Stiglitz (2010) reported that small-business credit card rates were skyrocketing at a rate far greater than consumer cards. This report sums up the problems of money prices on smaller businesses. The banks overall considered small businesses a major risk. Major banking firms normally work with large businesses because they are more stable and

have a large group of financiers who hold equity. They usually are also firms of long standing who can quickly produce market reports and strategic plans that banks love to see. Smaller firms have fewer resources for these important projects.

According to Hoff and Stiglitz (1990), Weaknesses in enforcement of financial contracts create credit management problems exposing banks to legal and credit risk. These weaknesses may be manifested in an inability to make sufficiently restrictive agreements that prevent borrowers from diverting funds away from the intended purpose (fungibility), failure to disclosure accurate information on borrowers, as well as an inability to write easily enforceable legal contracts. A weak legal system (without clearly spelt out property rights) also narrows the scope of institutions and therefore the opportunity to diversify the asset portfolio. As a result, the premium charged on credit is high, keeping lending rates high and widening the interest rate spread.

The unstable macroeconomic environment that the banks find themselves in serves to exacerbate the incentive problem and increase what we might call policy-induced risks due to unstable prices and hence unpredictable returns. Similarly, the incentive problem worsens the macroeconomic conditions. Uncertainty created by price volatility increases risk, while deteriorating macroeconomic performance impacts on the creditworthiness of the borrower. Stiglitz (1990) A decline in output or the price of outputs reduces the value of assets for collateral, thus reducing that creditworthiness. Poor economic performance also impacts on investment returns. Poor business returns imply a weak position for the small enterprises for repaying loans and thus the loan default rate increases. It may also reflect distress borrowing as small enterprises borrow to repay previous loans. Consequently, productive investment declines, accelerating the deterioration in economic performance. This in turn perpetuates the increase in risk premium charged on loans. In addition, market segmentation, where there are preferred banks for deposit and credit allocation as a result of political patronage, may polarize the financial sector and increase risks, thus maintaining inefficiency in the intermediation process. Most of these factors are applicable to Kenya's financial sector and show why interest rate is a topical issue for research attention in the policy arena. A concerted effort should be made to document these

factors, demonstrate trends and thus propose policy options for reducing the interest rate spread and thus improve financial intermediation. It is hoped that a more growth-friendly environment would result and therefore private investments and savings would be stimulated.

It is often the case that personal rather than institutional criteria are used to determine the nature of risk in small business. With larger institutions, the risk is focused on the nature of the business itself. Since many smaller businesses revolve around the founder and owner, personal considerations become that much more important. This means that many small-business loans turn out to be personal loans. The higher the rate, the more personal property is at stake. Non-availability of credit for SMEs prevents them from engaging in productive enterprises or expanding their businesses. Limited access to bank credit can be attributed to bureaucracy and high interest rate which is in line with the first school of thought's assertion. This means that the high interest rates constrain the demand for credit. Evidence on the impact of financial sector liberalization on SMEs shows the following. Webster (1992), the financial sector liberalization did not improve access to borrowing by SMEs. They attributed this to tightening of monetary controls, introduction of high yielding securities to mop up liquidity, and efforts to raise the performance of loan portfolios. Steel and Webster (1989) also pointed out that growth of SMEs has been hampered by the difficulty of financing working capital and new investment. In our view, the latter implies that limitations on the credit to the Poor and SMEs can be explained by the information asymmetry model which portrays limited access to financial capital.

There is opportunity cost attached to decisions to lend monies to SMEs given the relative scarcity of finance. Banks normally feel reluctant to lend to SMEs and this affects the supply of credit to SMEs. Preliminary estimated from recent survey conducted in the year 2000 showed that out of 16 commercial banks in Ghana, only six provided credit equivalent to \$ 10 billion to the micro finance sub-sector which was in need of total credit demand of \$ 380 billion. The provision of credit to the tune of \$10 billion constituted only 1% of the loans and advances in the same year (Opare, 2001).

Small business is always a risk. Banks do not like risk, especially when economic times are slow and debt is high. Since interest rate increases are often interpreted as signals that it is not a good time to lend, these increases hit smaller firms first, and hardest. In other words, if the chances of getting a good rate at bank for a small business are low even in good times, it might be effectively impossible during bad times. Especially for start-ups, debt financing is a risky venture for a bank. Therefore, rate hikes can be, under many circumstances, the death blow for smaller firms. Walter.J. (2011), the primary issue in dealing with interest rates is risk. Interest rates reflect the banks' perception of the risk involved with a specific financial decision or funding project. Smaller businesses are particularly vulnerable due to their generally high debt and high failure rate. Even the tiniest rate hike or even the consideration of a rate hike can destroy smaller businesses. Among those small businesses that do not fail, profits remain razor thin, especially in times of economic hardship. Higher rates mean higher finance charges for credit cards, meaning that consumer spending has a tendency to go down. High rates do not just mean higher money costs, but they also mean cautious consumers. Even a small variation in consumer behaviour can mean the failure of a small business

In general, banks will provide financing for small and sized business only if there is quick profit. Small businesses are a huge risk. About 50 percent fail within the first year. This means getting financing at reasonable rates is often difficult, especially for start-up businesses. The main issue here is long-term versus short-term financing. Since longer-term financing is less risky and more stable, this is the way to go for smaller businesses, and longer maturities also mean that financial planning can be more long term and detailed, something that banks like to see. Variable rate loans are a problem when rates rise, since most of these loans are tied in to the Federal Reserve's prime rate. This will continue to be a problem as the Fed continues to consider higher rates. USA Today journal of May (2010), it is clear that the interest on business credit cards rises faster than on personal cards. This is because banks, especially local, smaller banks, are concerned about the financial problems of small and sized enterprises. In some cases, banks have dealt with this risk by creating loans. This means that a loan can be called in when a business does not meet its forecast. The forecast of the business model is what

prompts a bank to issue financing in the first place. If rates rise and consumer spending goes down or shifts then a bank can call in the loan, demanding full payment. This is enough to create a bankruptcy situation

Financial liberalization

According to Ngugi.W.(2000), Lending rates increased gradually after liberalization and were accelerating as the sector faced a more risky environment. In addition, Treasury bill rates were kept high so that the lending rates tended to follow the Treasury bill rate over time. Even with a favorable environment for flexible interest rates, the lending rates were sticky downwards; even when they did decline they settled at relatively high levels. The persistently high lending rates were attributed to inflationary expectations, expectations regarding exchange rate depreciation, high implicit taxes, poor loans portfolios, a non-competitive financial system, and an inefficient intermediation process. Given these trends in interest rates in both markets, a widening interest rate spread was thus evident, The debate on whether there has been a higher interest rate is better appreciated by looking at the context in which interest rate is defined and the trend of interest rate in the financial and economic crisis period of the 1970s through to early 1980s and the period of economic reforms. There are different interest rates, namely, lending/borrowing, deposit rate, bank rates among others. While interest rate levels and volatility have been used to assess the impact of financial liberalization on economic growth, interest rates are used as a measure of the impact of financial liberalization on efficiency in the intermediation process. In addition, the spread reflects economic activity in that it is used to forecast macroeconomic variables in small enterprises. Inefficiency in the intermediation process is attributable to the incentive problem, which includes both information and enforcement components. Opare,(2001). Information asymmetry promotes moral hazard and adverse selection problems, lack of accumulation of information capital and inadequate disclosure of information ameliorate both problems, allowing for efficient allocation in the asset portfolio. However, any information gathered in the pre-reform period is nullified by institutional and policy changes this will limit attempts by small enterprises to achieve the desired goals. Thus, banks are required to build up their

information capital once more. This is costly for the financial intermediaries as it calls for a change in institutional arrangements even though such investment is unavoidable if efficiency in the intermediation process is to be achieved. Ngugi.W.(2000)

2.2.3 Inefficient institutional infrastructure

In Kenya interest rates were liberalized in July 1991. Financial repression theory predicts that after liberalization positive real interest rates should be realized as nominal interest rates increase from the government set low levels when price stability is achieved. It was basically approved by the government in order to enable the performance of small enterprises countrywide. The financial system also gains efficiency in the intermediation process such that the interest rate spread between the lending and deposit rate narrows. In Kenya, however, nominal interest rates increased minimally immediately after liberalization, and as inflation accelerated very high negative real rates were recorded. Interest rate spread widened, indicating either inefficiency in the intermediation process with weak institutional infrastructure, and/ or macroeconomic instability, and or a non-competitive structure in small enterprises. Deposit rates remained at low and almost constant levels, while lending rates by financial lending institutions began moving upwards. This may be explained by several factors:

Lack of diversity in financial institutions has created an uncompetitive financial market. For example, the stock market was still in its infancy, there were constraints on individual investors competing for government securities with a strictly set minimum investment capital level.

Inflationary pressures because of lack of an appropriate mechanism to hedge against future inflation. This implies that there was a preference for holding inflationary hedges rather than deposits, whose rates were low and did not change to compensate for inflation.

Uncertainty on bank income earnings with macro and financial instability, and accumulated high liquidity coupled with lower credit demand. This reduced banks' commitment to repayment of costs for deposits.

A Treasury bill rate maintained at persistently high levels encourages banks to hold Treasury bills and thus relegate to the background their screening and monitoring roles in the financial intermediation process.

Adverse selection of business owners

According to Stiglitz and Weiss (1981), high interest rates lead to adverse selection of loan seekers and owners of small enterprises that affect loan repayment. Repayment rate will not be 100% at a positive interest rate. Assuming the project return is very low, borrowing at zero interest rate will still not make the borrowers capable of repaying the loan. Thus a positive interest rate increases cost of production, reduces returns from a productive activity and promotes efficiency in the operations of small enterprises.

The modern approach to problems of credit markets especially markets which serve SMEs is based on the theoretical exposition of Hoff and Stiglitz (1990) which emphasizes imperfect information and imperfect enforcement of loan contracts. The two authors based their observations on screening, incentive and enforcement problems. The screening problem is due to the inability of small enterprises to determine satisfactorily the extent of risk inherent in projects submitted for credit facilities. The incentives problem is the cost which lenders would have to incur to make certain that borrowers take the appropriate actions to enhance loan repayment. The enforcement problem, essentially, occurs due to limitations of legal provisions for the enforcement of repayments of loans, for example, the selling collaterals.

The drawbacks of increasing government spending through increasing taxes, particularly taxes on business investment, according to Ndungu.S.(2001), substitution effects - such as: High investment tax rates cause international investors to switch their investments to countries with more favourable tax regimes and High investment tax rates lower the expected return-on-investments on projects involving some risk as a company pays 100 percent of their losses (if they lose money), since their profits are taxed. Because of this asymmetry, a lot of worthwhile projects may not be undertaken if tax rates are too high.

However, after co-founding a small business over 3 years ago, that for small and -sized enterprises income effects are vitally important and

Consider the wide spread between the interest rates small businesses can earn on their savings and the interest rates they must pay to finance projects. In Canada, a small business can open a savings account with a credit union or a bank and receive an interest rate in the neighbourhood of prime-minus-one percent. However, if that same small business tries takes a loan for an investment that lacks an obvious collateral value, such as a database or a specialized piece of equipment, they will be charged something in the neighbourhood of prime -plus-seven or plus-eight percent. The last business loan our company qualified for was at 13.5 percent, while at the same time my personal variable rate mortgage was at 4.5 percent. The big difference is due to the fact that the bank can foreclose on my house if we default, but many business loans are for items with little re-sale value on the open market, so there is no obvious source of collateral. It has not been considered the time and expense it takes for companies to obtain financing and whether companies will be able to obtain financing at all. Take it from this entrepreneur - obtaining a significant amount of small business financing in a country with a sclerotic banking system such as Canada is no easy feat. When these additional factors are taken into account, the income affect story, at least when applied to small business, is even more persuasive.

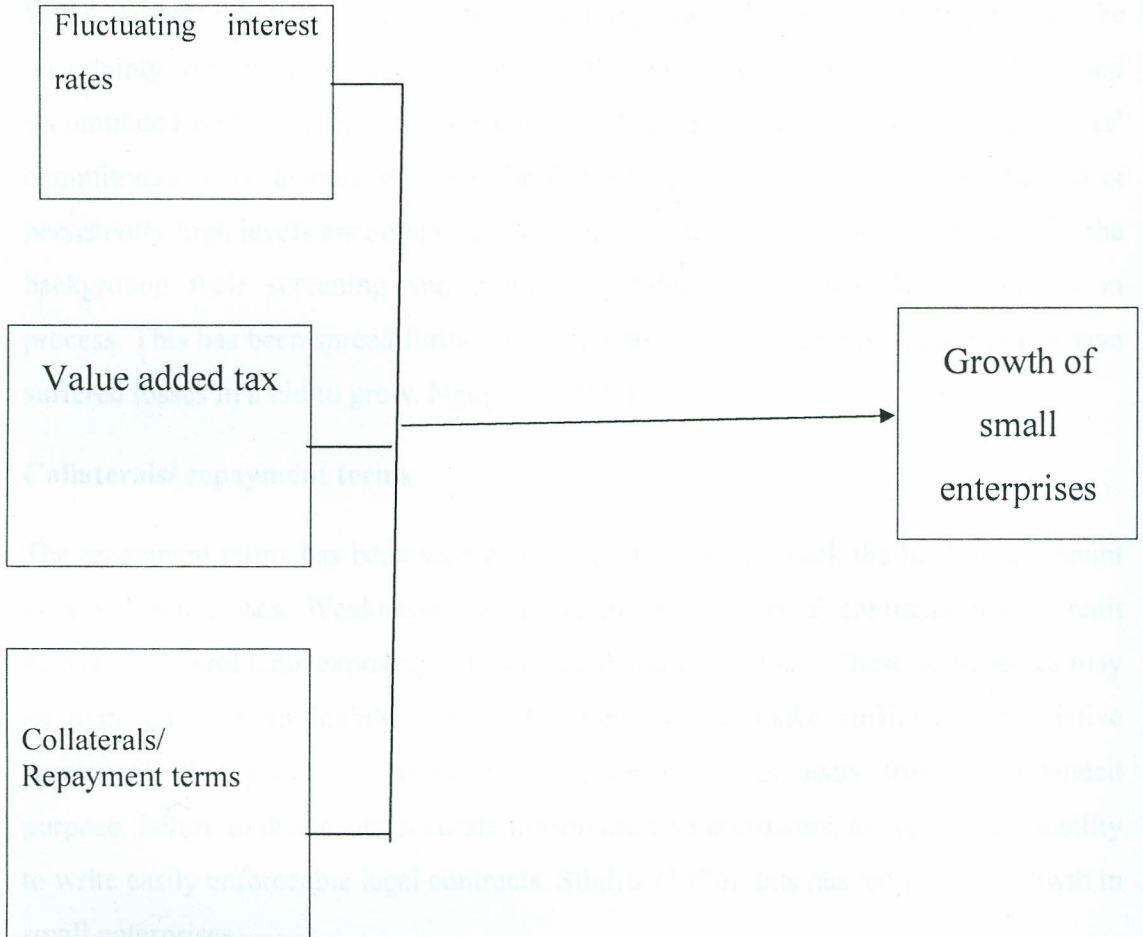
Many past research studies concentrated their research mainly on the contributions of interest rates on the performance of financial lending institutions. These researchers failed to attribute that the interest rates given by the financial institutions affect the operations of enterprises particular small enterprises. Ngugi.W.(2000) for example, believed that, aggregate investment is inversely related to the rate of interest but, this relationship has been observed to a weak one; that is, investment tends to be fairly interest-inelastic especially in entry and survival in small enterprises, because it is influenced by entrepreneur's expectations, and yields are normally estimated within a particular range, So if a small increase in the interest rate occurs, it will not disturb the long-run expansion of the enterprises but its continuous increase of interest rates may affect its performance simply because the cash inflows cannot meet the expectations of

cash outflows therefore it may trigger profitability index thus the enterprise may run at a loss.

According to Hoff and Stiglitz (1990), for example, Weaknesses in enforcement of financial contracts create credit management problems exposing banks to legal and credit risk. These weaknesses may be manifested in an inability to make sufficiently restrictive agreements that prevent borrowers from diverting funds away from the intended purpose (fungibility), failure to disclosure accurate information on borrowers, as well as an inability to write easily enforceable legal contracts. A weak legal system (without clearly spelt out property rights) also narrows the scope of institutions and therefore the opportunity to diversify the asset portfolio. As a result, the premium charged on credit is high, keeping lending rates high and widening the interest rate spread but, these researcher did not address to what extend does this high lending rates can affect the performance of small enterprises and how can it be solve to ensure fare interest rate to small entrepreneur. Furthermore the researcher failed to address the fact that such a weak legal system in financial lending institutions can limit the opportunity of an entrepreneur to diversify especially the asset portfolio.

According to Nissanke and Aryeetey (1995), for example, this researcher revealed that the financial sector liberalization did not improve access to borrowing by SMEs. They attributed this to tightening of monetary controls, introduction of high yielding securities to mop up liquidity, and efforts to raise the performance of loan portfolios Nissanke (1995), points out that growth of SMEs has been hampered by the difficulty of financing working capital and new investment. To the researcher, the latter implies that limitations on the credit to the Poor and SMEs can be explained by the information asymmetry model which portrays limited access to financial capital but, these two researchers did not point out, to what extend does liberation affect the entrepreneur in estimating the cash inflows in settling out the bills brought about by high interest rates.

2.4 Conceptual Framework



Explanations

Fluctuating interest rates

Fluctuating interest rates has caused disequilibrium in the market. The situation is mainly explained by the availability of deposit resources, the alternative investment channels for banks and the ease of portfolio adjustment at the end of the period. This has caused slow growth of small enterprises. However, Institution constraints, market micro-structures and policy actions explain substantial variations in interest rate spread. This is because of their impact on the transaction costs and a compounding effect from risk and uncertainty in the market.

Value Added Tax

Value Added Tax has caused more challenging situations on small enterprises. The uncertainty on bank income earnings with macro and financial instability, and accumulated high liquidity coupled with lower credit demand. This reduced banks' commitment to repayment of costs for deposits. A Treasury bill rate maintained at persistently high levels encourages banks to hold Treasury bills and thus relegate to the background their screening and monitoring roles in the financial intermediation process. This has been spread further to small enterprises which have been seen to have suffered losses in a bid to grow. Ngugi W.(2000)

Collaterals/ repayment terms

The repayment terms has been seen as the weakness to pay back the borrowed amount by small enterprises. Weaknesses in enforcement of financial contracts create credit management problems exposing banks to legal and credit risk. These weaknesses may be manifested in an inability of small enterprises to make sufficiently restrictive agreements that prevent borrowers from diverting funds away from the intended purpose, failure to disclosure accurate information on borrowers, as well as an inability to write easily enforceable legal contracts. Stiglitz (1990), this has led to slow growth in small enterprises.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.0 Overview

It includes research design, target population, sampling design, sample size determination, data collection instruments, validity and reliability of each instrument.

3.1 Research design

Descriptive research design was used. This was used because it enables the study to capture the gist of the respondents' views in their own words. This design was convenient as targeted population is large and stratified according to gender.

3.3 Target population

Table 1.1 Population

Small enterprises	Population
Chepseon market	100
Lodiani urban	100
Litein urban	300
Kapsoit market	70
Kericho town	700
Fortenan	30
Roret	200
Total	1500

Source: (2013)

3.4 Sample size determination

Mugenda (1999), general sample size can be estimated by;

Since the population is less than 10000, confidence level is 95%

$$n = z^2 \times p \times q / e^2$$

Where,

$z = 1.96$ – critical standard score

p = probability of being involved or not involved

$e = 0.05$ -variance constant

$$q = 1 - p$$

$$q = 1 - 0.5$$

$$n = 1.96^2 \times 0.5 \times 0.5 / (0.05)^2$$

$$= 1.96^2 \times 0.5^2 / 0.05^2$$

$$= 0.9604 / 0.0025$$

$$n = 384$$

Therefore, the final sample size will be;

n_f - final sample size

n - General sample size

N - Total target population

$$n_f = n / (1 + n/N)$$

$$= 384 / (1 + 384/1500)$$

$$= 384 / (1 + 0.256)$$

$$= 384 / 1.256$$

$$= 305.7$$

$$= 306$$

Therefore the sampled population is 306 respondents

3.4 Data Collection Instruments and Procedures

Research instruments are tools by which data is collected. The data was collected by aid of questionnaire. A questionnaire is a list of questions in a set form that is developed to address specific objectives, research questions of the study both closed and open ended questions was used. Part one of the questionnaire addressed personal information of the respondent, while part two of the questionnaire addressed information related to effects of interest rates on the growth of small enterprises.

3.5 Validity of Research Instruments

Mugenda and Mugenda (2000) define validity as the accuracy and meaningfulness of influence which are based on research thus enabling the researcher to verify the accuracy of the instruments used. The questionnaire is accurate since respondents find them more acceptable and convenient. It is also easy to tabulate and analyze. The validity of the instruments used was achieved by discussing the relevance of the research instruments with the supervisor to ensure simple and accurate questions provide simple answers.

3.6 Reliability

Reliability determines the appropriateness of the research instruments of this study. Reliability indicates how the measures are supposed to measure. The reliability was measured using Cronbach's Alpha reliability coefficient for Likert-type scale.

The reliability can be achieved by pre-testing the questionnaire in enterprises in Kericho County. Pilot study was conducted.

3.7 Data analysis and presentation

Analysis is the process of simplification and interpretation of data. The data was analyzed by use of both quantitative and qualitative method of data analysis. It was used to generate descriptive statistics to analyze for frequencies, means and percentages. Statistical Package for Social Science was used to analyze data. The questionnaires were screened for completeness and then coded and formatted. The results were reported using descriptive statistics such as frequency tables, pie charts and graphs. The findings were used to make inferences.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATIONS AND INTERPRETATION OF THE FINDINGS

4.1 Introduction

This chapter presents the analysis of data collected, presentations and interpretation of the findings.

4.2 Presentations

The total questionnaires issued were 306, only 210 were returned and 70% of the returned questionnaires were filled correctly. That gives 147 total data response used for analysis.

4.2.1 Gender of the respondents

Table 4.1: Gender of the respondents

Gender	Frequency	Percent
Male	98	66.7
Female	49	33.3
Total	147	100.0

Source: Researcher (2013)

The data collected revealed that majority of the respondents are males. 66.7% of the population indicated that they are males. Only 33.3% of the same population issued with questionnaires to fill indicated that they are females.

This indicates that most of the entrepreneurs that operate small enterprises are males, few are females. Therefore women in the community should be encouraged to venture in to small businesses to sustain their livelihoods.

4.2.2 Age bracket

Table 4.2: Age bracket

Age bracket	Frequency	Percent
20-25 years	32	21.8
26-30 years	63	42.9
31-35 years	40	27.2
36-40 years	8	5.4
41 years & above	4	2.7
Total	147	100.0

Source: Researcher (2013)

The findings revealed that, majority of the entrepreneurs in Kericho County operating on the small enterprises falls in the age bracket 26-30 years of age. 42.9% responded positively on this. The research data revealed that most of the entrepreneurs fall in the age bracket 31-35 years of age; this was responded by 27.2% of the total population issued with questionnaires to fill. This further showed that such kind of small entrepreneurs have operated for a very long time in the business. Moreover, research findings showed that only 21.8% of the remaining population is under the age bracket 20-25 years and therefore most of them are new to the business. The early investment in the entrepreneurship will enable them to earn a living through engaging in small enterprises, this will sustain their livelihoods. The least population issued with questionnaires to fill indicted that they fall in the age bracket 36-40 years of age, hence an indication that the small enterprises has helped them sustain their livelihoods. This was responded by 5.4% of the total population issued with questionnaires to fill. Only 2.7% of the remaining population issued with questionnaires to fill indicated that they have operated small enterprise for 41 years and above.

This implied that most entrepreneurs are in the age 26-30 years; therefore they are very energetic to operate the business through hard work in meeting the demands of a competitive environment. This age group shows that they can build empires if they

instill a positive attitude towards entrepreneurship, by positively embracing challenges and finding immediate solutions for frequent occurring business.

4.2.3 Level of education

Table 4.3 Level of education

Level of education	Frequency	Percent
Secondary level	52	35.4
Diploma level	34	23.1
Degree level	18	12.2
Masters level	43	29.3
Total	147	100.0

Source: Researcher (2013)

The data collected revealed that most of the entrepreneurs in Kericho County have attained the secondary school level in their level of academics. This was responded by 35.4% of the total population issued with questionnaires to fill. This has caused slow growth in their entrepreneurship since they lack enough knowledge on management and operations of their small enterprises. 29.3% of the remaining population showed that they hold masters, preferably in entrepreneurship. Most of them are civil servants and others in private organizations whereby they earn a basic income and therefore do not concentrate so much on small enterprises, therefore, the business they operate on is mainly for subsistence and thus profits accumulated are used to cover up their wants. Only 23.1% of the same population hold diploma thus, has full potential to move the small enterprises to the next level. Respondents showed that those who hold diploma certificates are the most active in business and make profits. 12.2% of the same population issued with questionnaires to fill has degree as their highest level of education attained.

However, the research findings imply that the most educated has little time to concentrate on their business. They are suppose to be the ones who bring in policies to guide the business so as to meet demands and makes profits that will surpass the effect of interest rates.

4.2.4 Duration of service in business

Table 4.4 Duration of service in business

Duration	Frequency	Percent
Below 2 years	55	37.4
3-6 years	42	28.6
7-10 years	30	20.4
11 years & above	20	13.6
Total	147	100.0

Source: Researcher (2013)

The research findings revealed that, majority of the respondents have served for quite a long time in the small enterprises. 28.6% of the total population indicated that they have been in small enterprises for 3-6 years. This showed that they have gained experience enough to survive in the business for quite a long time. Only 37.4% of the same population issued with questionnaires to fill showed that they have served for duration not more than 2 years. The population indicates that, they just started venturing in the business with an aim of maximizing profits in a short term or long term depending on the returns they get after buying and selling commodities. Some of the respondents that constitute 20.4% of the total population issued with questionnaires to fill showed that they have been operation in small enterprises for a length of time up to 7-10 years. They have actually registered a record of performance in small entrepreneurship despite frequent challenges they have been facing over a long period of time. 13.6% have served for 11 years and above.

This implies that most of small enterprise has just been started and therefore have not kicked on well as expected. The population who has served for quite a longer time in business ought to develop new skills and ways of developing and expanding the business.

4.2.5 Response to interest rates

Table 4.5 Response to interest rates

Response	Frequency	Percent
Yes	102	69.4
No	45	30.6
Total	147	100.0

Source: Researcher (2013)

From the data collected, the research findings showed that they agree on the effect of interest rates on the performance of small enterprises within Kericho Town in Kericho County. 69.4% of the population agreed and the remaining 30.6% disagreed.

This implied that small enterprises have suffered from high and fluctuating interest rates that have impacted negatively on the performance of small enterprises.

4.2.6 Extent of interest rates

Table 4.6 Extent of interest rates

Interest rates	Frequency	Percent
High extent	62	42.1
Some extent	48	32.7
Low extent	37	25.1
Total	147	100.0

Source: Researcher (2013)

The research data revealed that interest rates levied by financial lending organizations impact negatively on its growth and performance to a high extent. This was responded by 42.1% of the total population issued with questionnaires. This has in one point led to decline in the profits or annual turnover in small enterprises business. The business owners lack entrepreneurial skills management and therefore over time they hardly grow as expected of any business venture. This has affected the overall performance of small enterprises to some extent. This was responded by 32.7% of the total population.

25.1% of the same population indicated that interest rates affect the growth of small enterprises to a low extent.

4.2.7 Repayment terms

Table 4.7 Repayment terms

Repayment terms	Frequency	Percent
Yes	49	33.3
No	98	66.7
Total	147	100.0

Source: Researcher (2013)

From the data collected, the research findings revealed that majority of the respondents are not happy with the repayment terms that do not favor them. This was shown by 66.7% of the total population issued with questionnaires. Only 33.3% of the same population indicated that repayment terms do favor them.

The response implies that interest rates offered by financial institutions do not favor small enterprises in Kericho County.

4.2.8 Credit Management

Table 4.8 Credit Management

Credit Management	Frequency	Percent
High debt	54	36.7
High exposure to risk	34	23.1
Inflexibility	29	19.7
High failure rate	30	20.4
Total	147	100.0

Source: Researcher (2013)

From the data collected, the research findings showed that there are some effects of credit management on small enterprises. Small enterprises face a huge challenge in settling debts accrued due to low capacity to settle such bad debts on time. This was responded by 36.7 % of the total population issued with questionnaires to fill. Only

23.1% indicated that there is high exposure to risks which include; theft, fraud, destructions by fire among others. Banks faces risks in trying to collect the amount loaned to these small scale enterprises. The research findings revealed that small enterprises are majorly affected by inflexibility of their operations. This comes as a result of poor loan balance remittance to the banks which further affect the flexibility in liquidity. This was high interpreted 19.7% of the total population issued with questionnaires to fill. Only 20.4% of the total population indicated that majority of small enterprises has collapse and therefore they are dormant, this has affected the operations of other businesses since their existence impact on the growth of other small enterprises in order to ensure competitive environment is ensured.

4.2.9 Instability

Table 4.9 Instability

Instability	Frequency	Percent
Disequilibrium	34	23.1
Enterprise constraints	54	36.7
Risks premiums	30	20.4
Moral hazards	29	19.7
Total	147	100.0

Source: Researcher (2013)

From the data collected, the research findings showed that, Interest rates has caused instability of small enterprises. This was responded by 37% of the population issued which indicated that interest rates did not follow the theoretical expectations either in level. However, 20% of the same population indicated risk premiums levied by interest rates. It increase initially, and when the interest rates rose and were positive in real terms they were also very high, an indication of financial distress and instability. Therefore, from the findings, moral standards and adverse selection is another sign of instability. 19% of the same population responded to this. There were also attempts at institutional reforms in the financial and other sectors. The reform process, however,

failed in several respects to meet preconditions for successfully financial reform. The research study further showed that, Disequilibrium in the loans market is a major factor that propels the widening of interest rate spread. The situation is mainly explained by the availability of deposit resources, the alternative investment channels for banks and the ease of portfolio adjustment at the end of the period. This was responded by 23.1% of the total population.

4.2.10 Institutional infrastructure

Table 4.10 Institutional infrastructure

Institutional infrastructure	Frequency	Percent
Diversity	40	27.2
Inflationary pressures	52	35.4
Uncertainty on income earnings	20	13.6
Regulations on treasury bills	35	23.8
Total	147	100.0

Source: Researcher (2013)

The research findings showed that Lack of diversity in financial institutions has created an uncompetitive financial market. This was responded by 27.2% of the total population issued with questionnaires to fill. For example, the stock market was still in its infancy, there were constraints on individual investors competing for government securities with a strictly set minimum investment capital level. However, 35.4% showed that Inflationary pressures because of lack of an appropriate mechanism to hedge against future inflation. This implies that there was a preference for holding inflationary hedges rather than deposits, whose rates were low and did not change to compensate for inflation.

From the research findings showed that, uncertainty on bank income earnings with macro and financial instability, and accumulated high liquidity coupled with lower credit demand. This reduced banks' commitment to repayment of costs for deposits. This was indicated by 13.6% of the same population issued with questionnaires.

CHAPTER FIVE

SUMMARIES OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter presents the summaries of the findings, conclusions, recommendations and suggestions for further studies

5.1 Summaries of the findings

Majority of the entrepreneurs in Kericho County are males, few are females. Most of these males operating on small enterprises fall in the age bracket 26-30 years of age. The entrepreneurs fall in the age bracket 31-35 years of age showed that such kind of entrepreneurs have operated for such a very long time in the business. The early investment in the entrepreneurship will enable them to earn a living through entrepreneurship, this will sustain their livelihoods. Most of these entrepreneurs have attained secondary school level as their highest education level attained. These entrepreneurs have served for a long period of time as 3-6 years.

However, the research findings imply that the most educated has little time to concentrate on their business. They are suppose to be the ones who bring in policies to guide the business so as to meet demands and makes profits that will surpass the effect of interest rates.

This implies that most of small enterprise has just been started and therefore have not kicked on well as expected. The population who has served for quite a longer time in business ought to develop new skills and ways of developing and expanding the business. The research findings showed that they agree on the effect of interest rates on the performance of small enterprises within Kericho town in Kericho County.

This implied that small enterprises have suffered from high and fluctuating interest rates that have impacted negatively on the performance of small enterprises.

The research data revealed that interest rates levied by financial lending organizations impact negatively on its growth and performance to a high extent. This has in one point led to decline in the profits or annual turnover in small enterprises business. The business owners lack entrepreneurial skills management and therefore over time they

hardly grow as expected of any business venture. This has affected the overall performance of small enterprises to some extent.

From the data collected, the research findings revealed that majority of the respondents are not happy with the repayment terms that do not favor them. The response implies that interest rates offered by financial institutions do not favor small enterprises in Kericho County.

From the data collected, the research findings showed that there are some effects of credit management on small enterprises. Small enterprises face a huge challenge in settling debts accrued due to low capacity to settle such bad debts on time. There is high exposure to risks which include; theft, fraud, destructions by fire among others. Banks faces risks in trying to collect the amount loaned to these small scale enterprises. The research findings revealed that small enterprises are majorly affected by inflexibility of their operations. This comes as a result of poor loan balance remittance to the banks which further affect the flexibility in liquidity. Majority of small enterprises has collapse and therefore they are dormant, this has affected the operations of other businesses since their existence impact on the growth of other small enterprises in order to ensure competitive environment is ensured.

From the data collected, the research findings showed that, Interest rates has caused instability of small enterprises. Risk premiums levied by interest rates. It increase initially, and when the interest rates rose and were positive in real terms they were also very high, an indication of financial distress and instability. Therefore, from the findings, moral standards and adverse selection is another sign of instability. 19% of the same population responded to this. There were also attempts at institutional reforms in the financial and other sectors. The reform process, however, failed in several respects to meet preconditions for successfully financial reform. The research study further showed that, Disequilibrium in the loans market is a major factor that propels the widening of interest rate spread. The situation is mainly explained by the availability of deposit resources, the alternative investment channels for banks and the ease of portfolio adjustment at the end of the period.

The research findings showed that Lack of diversity in financial institutions has created an uncompetitive financial market. For example, the stock market was still in its infancy, there were constraints on individual investors competing for government securities with a strictly set minimum investment capital level. However, 35.4% showed that Inflationary pressures because of lack of an appropriate mechanism to hedge against future inflation. This implies that there was a preference for holding inflationary hedges rather than deposits, whose rates were low and did not change to compensate for inflation.

From the research findings showed that, uncertainty on bank income earnings with macro and financial instability, and accumulated high liquidity coupled with lower credit demand. This reduced banks' commitment to repayment of costs for deposits. Treasury bill rate maintained at persistently high levels encourages banks to hold Treasury bills and thus relegate to the background their screening and monitoring roles in the financial intermediation process. This has led to decline in the performance of small enterprise.

5.2 Conclusions

It is revealed that majority of small enterprises in Kericho Town, Kericho County is owned by males. There are few that are owned by female entrepreneurs. Most educated has little time to concentrate on their business. They are suppose to be the ones who bring in policies to guide the business so as to meet demands and makes profits that will surpass the effect of interest rates. However, small enterprises have suffered for a long time from high and fluctuating interest rates which have impacted negatively on the performance of small enterprises. This has been facilitated by high interest rates levied by financial lending organizations which have impact negatively on its growth and performance to a high extent. This has in one point led to decline in the profits or annual turnover in small enterprises business. The business owners lack entrepreneurial skills management and therefore over time they hardly grow as expected of any business venture.

Small scale entrepreneurs are not happy with the repayment terms which do not favor the business. The implied that interest rates offered by financial institutions do not favor small enterprises in Kericho County.

There are some effects of credit management on small enterprises. Small enterprises face a huge challenge in settling debts accrued due to low capacity to settle such bad debts on time. There is high exposure to risks which include; theft, fraud, destructions by fire among others. Banks faces risks in trying to collect the amount loaned to these small scale enterprises. However, small enterprises are majorly affected by inflexibility of their operations. This comes as a result of poor loan balance remittance to the banks which further affect the flexibility in liquidity. Majority of small enterprises has collapse and therefore they are dormant, this has affected the operations of other businesses since their existence impact on the growth of other small enterprises in order to ensure competitive environment is ensured.

Risk premiums levied by interest rates. It increase initially, and when the interest rates rose and were positive in real terms they were also very high, an indication of financial distress and instability. Therefore, from the findings, moral standards and adverse selection is another sign of instability. There were also attempts at institutional reforms in the financial and other sectors. The reform process, however, failed in several respects to meet preconditions for successfully financial reform.

Disequilibrium in the loans market is a major factor that propels the widening of interest rate spread. The situation is mainly explained by the availability of deposit resources, the alternative investment channels for banks and the ease of portfolio adjustment at the end of the period.

Lack of diversity in financial institutions has created an uncompetitive financial market. For example, the stock market was still in its infancy, there were constraints on individual investors competing for government securities with a strictly set minimum investment capital level. Moreover, Inflationary pressures because of lack of an appropriate mechanism to hedge against future inflation. This implies that there was a preference for holding inflationary hedges rather than deposits, whose rates were low and did not change to compensate for inflation.

The results drive a conclusion that uncertainty on bank income earnings with macro and financial instability, affect the performance of small enterprises accumulated high liquidity coupled with lower credit demand. This reduced banks' commitment to

repayment of costs for deposits. This has led to decline in the performance of small enterprise.

5.3 Recommendations

Women in the county should be encouraged to participate in activities that generate income at the end of a particular period. This was achieved from the data collected. However, this will be achieved by summoning women to form women groups in the community. Such groups will be funded through CDF or donor funds. Those entrepreneurs who are actively engaged in small business should be encouraged to join training workshops so as to equip themselves with skills and knowledge in order to assist them to overcome challenges they face.

Small entrepreneurs are therefore encouraged to market themselves outside the County, and adopt new skills of doing business through computer aided techniques. To mitigate risks, they are advised to insure the business premise. There is high exposure to risks which include; theft, fraud, destructions by fire among others. Banks faces risks in trying to collect the amount loaned to these small scale enterprises. However, small enterprises are majorly affected by inflexibility of their operations. Therefore, they should adopt flexibility in operations. Majority of small enterprises has collapse and therefore they are dormant, this has affected the operations of other businesses since their existence impact on the growth of other small enterprises in order to ensure competitive environment is ensured. The government through ministry of finance should regulate policies aimed at regulating the fluctuations of interest rates by banks because this has impacted negatively to the growth of small enterprises.

5.4 Suggestions for further studies

Little attention has been done in this area. Therefore, future research should concentrate on the following;

- a) Relationship between credit risk management and the profitability of enterprises in Kenya.
- b) Socio-economic factors affecting the growth of small enterprises in Kenya.
- c) The influence of savings and credit cooperative societies on the growth small enterprises

REFERENCE

- Agbeli.C. (2001) Poor loan recovery at HO assembly, daily graphic newspaper, Accra. Ghana.
- Aryeetey .E. & Nissanke.M. (2000), Invention and liberation; changing policies and performance in financial sector, economic resource in Ghana: the miracle and the mirage; Woei publishing limited, Accra Ghana.
- Expat Tax Returns Online journal Expat Tax Forms 2555, 1116, 8854 File US Non Resident Individual Tax www.expatriatetaxreturns.com2011.Nairobi Kenya. Journal USA Today; May (2010) Small Businesses' Credit Card Rates Now 13.7% Higher; Byron Acohido; USA
- Funkor S. (2000), Invention and liberation; changing policies and performance in financial sector, economic resource in Ghana: the miracle and the mirage; Woei publishing limited, Accra Ghana.
- Journal Trading EZ; April (2011) Guide to Small Business Loan Interest Rates; Byron Acohido;USA
- Journal Business Funding Experts; April (2011) Small Business Loan Rates; Byron Acohido;USA
- Hoff .K. & Stiglitz .J.E.Hardwick (1990), introduction; imperfect information and rural credit markets: puzzles and policy perspectives, the World Bank economic review, vol.4 washington.D.C
- Stiglitz .J.E.Hardwick (1990), introduction; imperfect information and rural credit markets: puzzles and policy perspectives, the World Bank economic review, vol.4 washington.D.C
- International monetary fund,(1990), international financial statistics, washington. D.C

Jordan (2010), economic modelling division, Kenya Institute for Public Policy Research and Analysis, Nairobi Kenya

Ndungu S.Njuguna & Ngugi W.(2000) macroeconomics and economic modelling division, Kenya Institute for Public Policy Research and Analysis, Nairobi Kenya.

Njuguna S.(2000) macroeconomics and economic modelling division, Kenya Institute for Public Policy Research and Analysis, Nairobi Kenya.

Walter J.(2011), USA Today journal: effects of interest rates on small enterprises, Acohio.USA

QUESTIONNAIRE

INSTRUCTIONS

Please respond to the following questions with utmost confidence and honesty by ticking where appropriate and giving comments, suggestions and opinions on space provided. Please DO NOT write your name anywhere in this questionnaire.

SECTION A: Background information of the respondents

1. Please indicate your Gender.

Male

Female

2. In which age bracket do you fall in?

(a) 20-25 years

(b) 26-30 years

(c) 31-35 years

(d) 36-40 years

(e) 41 years & above

3. Which level of education did you attain?

a) Secondary level

b) Diploma level

c) Degree level

d) Masters level

e) Others

4. For how long have you been working in this organization?

a) Below 2 years

b) 3-6 years

c) 7-10 years

d) 11 years & above

5. Please indicate your terms of service

a) Temporary

- b) Permanent
- c) Casual
- d) Contract

Section B: information based on the objectives

6. Do interest rates have an effect on small enterprise?

Yes No

7. If yes, does it have negative or positive impact on the performance of small enterprise?

- a) Positive
- b) Negative
- c) Both

8. What are the positive effects of interest rates on small enterprise?

.....

9. Are repayment terms favourable to you?

- a) Yes
- b) No

If Yes Give Comments

.....

10. What is the effect of credit management on small enterprises?

- a) High debt
- b) High failure rate
- c) Banks high exposure to risk
- d) Inflexibility
- e) Others, please specify

11. Please comment on your answer above

.....
.....
.....

12. Do instability of small enterprises due to high interest rates affects its performance?

Yes No

13. If yes, how does instability of small enterprises due to high interest rates affects its performance?

- a) Disequilibrium
- b) Enterprise constraints
- c) Risks premiums
- d) Moral hazards and adverse selection
- e) Tight liquidity situation

14. In your opinion, how do macroeconomic issues affect the performance of small enterprises?

.....
.....

15. Do inefficient institutional infrastructure on interest rates affect the performance of small enterprises?

Yes No

16. If yes, how does inefficient institutional infrastructure on interest rates affect the performance of small enterprises?

- a) Lack of diversity
- b) Inflationary pressures
- c) Uncertainty on banks income earnings
- d) Banks regulations on treasury bills
- e) Others, please specify

COVER LETTER

BENSON KIPROTICH KIKWAI
KENYATTA UNIVERSITY
SCHOOL OF BUSINESS
P.O. BOX 43844-00100
NAIROBI

TO WHOM IT MAY CONCERN

RE: REQUEST YO VISIT YOUR INSTITUTION

I am a Master's Degree student of Kenyatta University, School of Business and I am conducting a research project on the **Effects of interest rates on the growth of small enterprises in Kenya**. I therefore request you to assist me to collect data in your organization and I assure you that the information is used for academic purposes only and a copy of the same will be availed to your organization.

Yours faithfully

BENSON KIPROTICH KIKWAI