FACTORS THAT AFFECT FUNDING OF SMALL AND MEDIUM-SIZED ENTERPRISES IN THE RETAIL SECTOR IN NAIROBI, KENYA

Joel Ruo Ngeru[1] & Dr. Joseph Obwogi
School of Business
Jomo Kenyatta University of Agriculture and Technology P.O Box 62000-00200 Nairobi, Kenya.

ABSTRACT

Small and Medium-sized Enterprises (SMEs) are considered to be the major source of dynamism, innovation and flexibility in emerging and developing countries, since they have the potential to contribute significantly to economic growth and poverty reduction in a country through increased productivity and employment.. However, the survival and growth of the SMEs largely depends on their ability to access finance. Evidence shows that SMEs in most developing countries face a financing gap related to difficulties in their access to finance that undermines their economic prosperity. This study sought to determine the factors that influence funding of SMEs in the Retail Sector in Nairobi, Kenya. Specifically, the study sought to establish the effect of ownership structure and collateral on the funding of SMEs in the Retail Sector in Nairobi, Kenya. The study used a descriptive research design and was based on primary data collected from management staff of the sampled SMEs using a self administered questionnaire. Cluster sampling and simple random sampling techniques were used in sample determination. The clusters were based on the type of ownership structure of the business and included sole proprietorship, partnership and limited liability companies. An OLS regression analysis model and Pearson correlation were used to determine the relationship between the study variables. There were 31 sole proprietorships, 9 partnerships and 3 limited liability companies. The study established that ownership structure and collateral had a positive relationship with the SMEs' access to funding. The study found that most SMEs held motor vehicles, buildings and land as their collateral. Further it was found that most SMEs are owned by individuals either as sole proprietorships or partnerships. The study established that lack of separation between the firm and the owner affected the financing of SMEs and that privately held firms were likely to use more flexible financing instruments without others taking control in the firm. In addition, the study found that most of the SMEs received loans that were far much less than requested for due to lack of adequate collateral. The study concluded that SMEs' inability to access external funding was due to lack of collateral and that incorporation was associated with increased access to external funding given that incorporated firms had the ability to issue stock and their stockholders had the freedom to resell their stock which facilitated their process of accessing external finance for expansion. Based on the study findings the study recommends that SMEs should strive to own more tangible assets that can create higher value on their firms to accelerate borrowing security since the higher the value of assets the lower the interest rates of the debt to be secured by those assets. In addition, owners and managers of the SMEs should consider incorporation of their firms to increase their funding sources to issue of stocks. Further, incorporation would imply that the SMEs are able to benefit from adherence to strict financial reporting provisions and independent legal status which would in turn enhance their chances of accessing more external funding..

Keywords: Small and Medium-sized Enterprises, funds, ownership structure, collaterals.

INTRODUCTION

There is growing recognition of the important role small and medium-sized enterprises (SMEs) play in economic development. Small and medium-sized enterprises (SMEs) are described as efficient and prolific job creators, the seeds of big businesses and the fuel of national economic engines this is due to their major contribution to economic growth (Ayyagari, Demirgüç-Kunt & Maksimovic, 2008). Interest in the role of SMEs in the development process continues to be in the forefront of policy debates in most countries. Governments at all levels have undertaken initiatives to promote the growth and development of SMEs (Beck, 2017).

A major challenge in the development of the SME sector is access to finance given the relative importance of funding to this segment. Beck (2007) observed that accessibility to external finance source is essential to solve shortage of SMEs cash flows. Financing is required for the SMEs' to set up and enlarge their business operations, engage in new product development, research and development, human resource development and for them to acquire up-to-date production equipments and technology (Fatoki & Smit, 2011). Most of the SMEs are limited to internal finance since they cannot easily afford external finance. However, internal finance is still inadequate for these enterprises development and profitability (Ayyagari *et al*., 2008). Majority of the SMEs are strongly restricted in accessing the capital that they require to grow and expand, with over half of SMEs in developing countries rating access to finance as a leading constraint (Dong & Men, 2014). According to Sacerdoti (2005), among the reasons for SMEs' lack of access to credit from financial institutions in Sub-Saharan Africa are their inability to provide accurate information on their financial status, high cost of the credit, lack of collateral required, lack of credit history and cumbersome legal and judicial procedures in case of defaults. Other reasons include, long physical distance to the nearest financial services provider and socio-economic and demographic characteristics that make them less creditworthy (Gbandi & Amissah, 2014).

Most small business enterprises in the world face many obstacles for growth, especially in finance. The 2010 World Development Report showed that small firms had only 10-30 percent of their capitals from external sources, while large firms obtained upto 48 percent of their capital from external finance sources (World Bank, 2010). There exist many barriers for SMEs' access to bank loans, such as, lack of financial performance records, banks' unwillingness to lend to SMEs, lack of collateral, tax payment non-compliance reports, associated high default risks, unsound business plans and high lending rates (Yusof & Aspinwall, 2010). Even though small and medium sized enterprises contributed more than 40% of World's GDP in 2009, they only got 13% of the lending capital due to lengthy lending procedures, corruption, poor lending policies, lack of collateral and costly interest rates (World Bank, 2010). According to the recent survey of central institutions of economic management (CIEM), only 36% of SMEs in UK were able to access external capital in 2014 (Lee *et al*., 2015).

SMEs in Kenya are generally undercapitalized suggesting major operational difficulties in accessing credit and pursuing their business goals (Orinda, 2014). Wanjohi (2009) observed that 18.4% of the SMEs in Kenya cite access to credit as their second most severe constraint after market access. The limited access to credit has been attributed to factors such as lack of collateral, high risk profile of SMEs, information asymmetry problems, lack of records showing their financial performance and bias by the commercial banks against the SMEs (Ayyagari *et al*., 2008). Banks in most African countries have made little effort to reach SMEs due to difficulties in administering loans particularly in screening and monitoring the small scale borrowers, high costs of managing the loans and high risk of default (Kira, 2013).

Financing constraints for the small and medium sized enterprises operate in a variety of ways in Kenya. According to the Central Bank of Kenya, the level of SMEs' funding from external sources and particularly from the financial institutions still remains very low at 10-20% compared to the level of bank financing of SMEs in the developed countries at an average of 48-60% (CBK, 2013). The Central Bank of Kenya statistics on the level of SMEs' funding in Kenya is collaborated by statistics from the Kenya National Bureau of Statistics which showed that only 22% of the SMEs in the country were able to access funding from financial institutions in 2014 (KNBS, 2014). In her study of the relationship between access to credit and financial performance of SMEs in Nairobi, Kenya, Muguchu (2013) found that out of the 34 SMEs within the Nairobi Central Business District selected for the study, only 14.7% had been able to access funding from commercial banks over the past 5 years. It is therefore clear that access to funding remains a major challenge for SMEs in Kenya.

1.2 Statement of the Problem

There is growing recognition of the important role small and medium sized enterprises play in economic development in every country. SMEs have the capacity to achieve rapid economic growth while generating a considerable extent of employment opportunities (Aris, 2007). Studies

Vol. 1, No. 04; 2017

ISSN: 2456-7760

indicate that in both advanced economies and developing countries, SMEs contribute an average of 60 to 80 percent of total formal employment in the countries. For the African economies, the contribution of the SME sector to job opportunities is even more important since taking into account the contribution of the informal sector, SMEs account for over 75% of total employment. Thus, given their importance in all economies, the growth of SMEs is essential for a country's economic growth and development (Ayyagari *et al*., 2008).

Finance is the life-blood of any business enterprise and no enterprise, no matter how well managed, can survive without enough funds for working capital, fixed assets investment, employment of skilled employees and development of markets and new products (Dong & Men, 2014). Therefore, access to finance is essential to the survival and performance of any business enterprise. Studies by Haron et al. (2013) in Malaysia, Ackah and Vuvor (2011) in Ghana, Osano and Languitone (2016) in Mozambique and Coleman (2010) in US all revealed that lack of access to adequate financing was a major constraint to small businesses' growth and performance. Similarly, Abdesamed et al. (2014) observed that SMEs world over complained that their growth and competitiveness was severely constrained by their lack of access to enough financial resources.

Locally, Nondi and Achoki (2006), in a survey of financial management problems in small hotels and restaurants in Kenya, found that 26 percent of these establishments reported lack of working capital as the most serious problem they faced in their operations. Wanjohi (2009) in his study of the challenges facing SMEs in Kenya noted that lack of access to long-term credit for small enterprises forced them to rely on high cost short term finance. Further, a survey on small and medium sized businesses sponsored by the Danish government and released in Kenya, on April 2010, found out that players in this sector were dissatisfied with access to finance especially from major financial institutions in Kenya with only 12% indicating that they received required financial help with good repayment terms (Orinda, 2014). Although, a considerable number of research studies had identified access to finance as a major problem in the SME sector, a survey of the literature in this area indicated that there was a significant gap in knowledge of the factors that influenced SMEs' access to external funding. This is the gap that this study sought to fill.

1.3 Objectives

i. To determine the effect of ownership structure on funding of SMEs in the Retail Sector in Nairobi, Kenya

ii. To establish the effect of collateral on funding of SMEs in the Retail Sector in Nairobi, Kenya

1.4 Scope of the Study

The study was limited to 43 Retail Sector SMEs operating in Nairobi CBD based on Nairobi County Government SMEs Index Report of 2016 and which formed the geographical scope of the study.

2.0 LITERATURE REVIEW

2.1 Theoretical Review

The study was guided by three main theories, the Market Failure Theory, Pecking Order Theory and Agency Theory. These are as discussed below.

2.1.1 Market Failure Theory

The Market Failure Theory justifies the reason behind the inefficient supply of finances to SMEs in the market. According to the private market efficiency theory as discussed by Mendes (2004) posits that under certain circumstances private markets will allocate goods and services among individuals efficiently in the sense that no waste occurs and that individual tastes are matching with the economy's productive abilities. Banks and MFIs most of them being private entities do try and are able to provide efficient outcomes and if the SMEs were providing the right atmosphere, then there would be little or no scope of lack of finances. In many cases, however, conditions for private market efficiency are violated from the demand side through factors like information asymmetry, lack of clear risk management policy among others (Mendes, 2004). According to Marlow (1995) while discussing market failure theory he put it that under ideal conditions related to competition, information and the absence of externalities, private competitive markets allocate resources efficiently. For financier (debt and equity providers) to play a legitimate role the ideal conditions must be present and efficiency must be the most important criterion for directing resource allocation. "Market failure" occurs therefore when financial service providers in the markets do not allocate goods or services efficiently. The existence of market failure provides an efficiency-based rationale for concluding that SMEs are being limited in access to finance (Marlow, 1995).

2.1.2 Pecking Order Theory

Pecking order theory of capital structure states that firms have a preferred hierarchy for financing decisions. Firms will borrow instead of issuing equity when internal cash flow is not sufficient to fund capital expenditure. The highest preference is to use internal financing before resorting to any form of external funds. Internal funds incur no flotation costs and require no additional disclosure of financial information that may lead to a possible loss of competitive advantage (Baskin, 1989). If a firm must use external funds, the preference is to follow a certain order of financing sources: debt, convertible securities, preferred stock, and common stock (Myers, 2007). This order reflects the motivations of the business owner to retain control of the firm, reduce the agency costs of equity, and avoid negative market reaction to an announcement of a new equity issue. The amount of debt will reflect the firms' cumulative need for external funds (Marlow, 1995).

2.1.3 Agency Theory

Jensen and Meckling (1976) pioneered the concept of agency theory which explains that conflicts arise between the shareholders, managers and lenders collectively known as principal – agent problems. The conflict between stockholders and management arise when managers are not performing to attain the shareholders' value maximization goal. Literally, shareholders incur costs monitoring the managers and influencing their action in order to ensure that the managers make viable decisions for the prosperity of the firm. In contrast, lenders are united with the shareholders in requesting firm's performance, but when the firm faces difficulties this unity of the purpose can collapse. The common goal of the union between lenders and shareholders is to take several necessary measures to rescue the firm. Interest on agency relationships arises from the fact that there are entrepreneurs who have a knack for accumulation of capital and managers who have good ideas on how to effectively use that capital. Since the owners of the capital (entrepreneurs), in most cases, have neither the requisite expertise nor time to effectively run their enterprises, they hand the enterprises over to the agents (managers) for control and day-to-day operations, hence, the separation of ownership from control, and the attendant agency problems (Stiglitz, 2004).

2.2 Empirical Review

2.2.1 Ownership Structure and Funding of SMEs

Firm ownership can be categorized in several ways depending on how they are incorporated. For example sole proprietorship, partnership and companies. Hall (2010) demonstrated that incorporated firms under limited liability, have higher growth than unincorporated firms. Several factors could explain the association between incorporated firms and growth. First, corporations have the ability to issue stock and their stockholders have the freedom to resell their stock. This ability facilitates the process of accessing finance for expansion. Haron et al. (2013) observed that lenders may perceive incorporation as a sign of credibility and formality of operations. Consequently, incorporated firms appear to be in a very favoured position in receiving external funding in comparison with unincorporated firms. Abor and Biekpe (2006) argued that the form of ownership could affect the debt-equity decisions of firms. He further argued that corporations and limited liability companies may be more likely to finance their projects with equity while sole proprietors are more likely to employ debt financing. Coleman (2010) found evidence suggesting a positive relationship between leverage and incorporation.

From the financier's point of view, as SMEs are by nature characterized by concentrated ownership and control in the same owner–manager, which leads to maximizing the information asymmetry problem, the reluctance in lending to SMEs and the extensive use of collateral are understandable and justified (Hutchinson, 1999). Consistent with this, Petty and Bygrave (1993) inferred that the lack of separation between the firm and the owner affected the financing preferences of the firm. Ferrando and Griesshaber (2011) revealed that the ownership structure of a firm influences which types of financing sources are used. They observed that families, teams and single-owner firms are more likely to avoid external finance and especially financing instruments, where others gain control rights in the firm. Hence, privately held firms are expected to use more flexible financing instruments without others taking control in the company (Ferrando & Griesshaber, 2011).

2.2.2 Collateral and Funding of SMEs

Collateral are very important to leading. In other financiers' collaterals is a must for any firm to be issued with funds. Ackah and Vuvor (2011) in their study of the challenges faced by SMEs in obtaining credit in Ghana indicated that access to bank credit by SMEs has been an issue repeatedly raised by numerous studies as a major constraint to industrial growth. They noted that a common explanation for the alleged lack of access to bank loan by SMEs is their inability to pledge acceptable collateral. They claimed that the availability of collateral plays a significant role in the readiness of banks to meet the demand of finance of the private sector. Collateral provides an incentive to repay and offset losses in case of default. Thus collateral was required of nearly 75 percent of sampled firms that needed loans under a study, which they conducted on the demand supply of finance for small enterprises in Ghana. The study also indicated that 65 percent of the total sample firm had at various times applied for bank loans for their business. However, the firms received loans that were far much less than they requested for. Among the firms that had their loan applications rejected, lack of adequate collateral (usually in the form of landed property) was the main reason given by banks (Ackah and Vuvor, 2011).

Matibe (2005) set out to study the relationship between ownership structure and capital structure for listed firms in Kenya and their financial performance. The study covered five years, between 1998 and 2002. Correlation analysis was used to analyze the collected data. The study found out that firms owned by the state were more likely to borrow than those owned by individuals, institutions or foreign investors. He concluded that state owned firms have more access to debt than firms owned by individuals and foreign investors. The study attributed this finding to the extensive fixed asset portfolio mainly held by the state owned firms compared to firms owned by individuals, which meant that they easily met the collateral requirement for long-term financing asked by most banks.

3.0 RESEARCH METHODOLOGY

The study adopted a descriptive research design which enabled a clear presentation of the variables under investigation. The target population was 432 registered Retail Sector SMEs operating in Nairobi CBD per the Nairobi County Council 2016 SMEs' Index Report. The clusters were based on the type of ownership structure of the business and included sole proprietorship, partnership and limited liability companies. The study had a sample size of 43 firms representing 10% of the population. Primary data was collected from senior management staff of the sampled SMEs. The data was quantified and the relationship between the variables estimated using an OLS model as stated below;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

Where;

Y is Funding of SMEs
X_1 is Ownership structure
X_2 is Collateral
β_0 is Constant
$\beta_1 - \beta_2$ is Regression coefficients
ε is Error term

4.0 FINDINGS AND DISCUSSION

4.1 Descriptive Statistics

4.1.1 Effect of Ownership Structure on Funding of SMEs

The study sought to establish the effect of ownership structure on funding of SMEs in the Retail Sector in Kenya. The SMEs' ownership structure forms included sole proprietorship, partnership and limited liability companies. In a scale of 1-5, it was established that privately held firms were more likely to use more flexible financing instruments without others taking control in the company with a mean of 4.35. However, unincorporated firms lacked the ability to issue stock which limited their financing options scoring a mean of 4.00. This indicated that majority of the respondents were unanimous that the SMEs' ownership structure affected their funding to a great extent. This was supported by Haron *et al*. (2013) who observed that lenders may perceive incorporation as a sign of credibility and formality of operations. Further the findings are supported by finance literature as incorporated firms appear to be in a very favoured position in receiving external funding in comparison with unincorporated firms. This also agreed with Petty and Bygrave (1993) who while commenting on financing challenges faced by SMEs inferred that lack of separation between the firm and the owner affected the financing preferences of such firms. This also concurred with Ferrando and Griesshaber (2011) who argued that the ownership structure of a firm influences which types of financing sources are used with family-owned and single-owner firms being more likely to avoid external finance and especially financing instruments, where others gain control rights in their firm.

4.1.2 Effect of Collateral on Funding of SMEs

The study sought to establish the effect of effect of collateral on funding of SMEs in the Retail Sector in Kenya. The study sought to establish whether the SMEs owned the premises on which their businesses were operating. The findings indicated that majority (83.7%) did not own the premises that housed their business with a minority (16.3%) owning the premises. This implied that majority of the respondents' businesses were operating from a rented premise. This agreed with Myers (2007) as well as Abdulsaleh and Worthington (2013) who observed that most of the small and medium enterprises in both urban and rural areas operated from rented buildings.

Regarding the value of the long-term assets that the SMEs businesses had, the study found that 37.2% of the respondents' enterprises had assets valued below Kshs. 500,000, 30.2% had assets valued between Kshs. 500,000 and Kshs. 2,000,000, 25.6% had assets valued between Kshs. 2,000,001 and Kshs. 5,000,000 while 2.3% had assets valued above Kshs. 5,000,000 with 4.7% of the respondents not indicating the value of their enterprise's assets. This information was in line with the contents of the books of accounts of the sampled SMEs which on average showed that the SMEs' assets were valued between Kshs. 500,000 and Kshs. 5 million. This implied that the SMEs owned and held long-term assets of relatively low values (that is, of below Kshs 5 million), meaning they did not have adequate collateral in case of a big loan. This agreed with Olawale and Garwe (2010) who asserted that majority of the small and medium enterprises in developing countries hold low value assets which severely affects their ability to access external funding more so from the banking institutions which require collateral for loaned amounts. This also agreed with Ayyagari *et al*. (2008) who noted that most of the SMEs rely on internal finance since they cannot easily afford external finance. They added that majority of the SMEs are strongly restricted in accessing the capital that they require to grow and expand, with the inability to pledge appropriate collateral, being one of the leading impediments to their access of external funding particularly from the financial institutions.

Those findings were consistent with Ackah and Vuvor (2011) who in their study found that among the firms that had their loan applications rejected, lack of adequate collateral (usually in the form of landed property). On their part, Yusof and Aspinwall (2010) argued that small firms faced difficulties to access external finances for their investment projects because of lack of assets to be pledged as collateral. They observed that in that perspective SMEs fail to grow due to lack of collateral to pledge to access external sources of finance. Similar sentiments were shared by Deakins *et al*. (2010) who pointed out that the requirement of collateral is a crucial aspect for SMEs to succeed in accessibility of external financing from lenders in that the collateral served as insurance that the lender's contract would be honored and respected.

4.1.3 Funding of SMEs

The study sought to establish a number of aspects relating to the funding of the SMEs including the major sources of the SMEs' financing, whether the respondents considered financing as a leading constraint to their enterprises' growth, the percentage of funds received compared to funds applied for and major barriers to the SMEs' access to funding from the financial institutions. The findings are as illustrated in Table 4.3.

Table 4.3 Funding of SMEs

statement	Frequency	Percentage
Major source of business financing		
Ploughed back earnings	21	48.8
Personal savings	22	51.2
Whether financing is a leading constraint to the SMEs' growth		
Yes	42	97.7
No	1	2.3
Percentage received of funds applied for		
Less than 5%	3	7.0
Between 5% - 10%	27	62.8
Between 11% - 20%	12	27.9
More than 20%	1	2.3

From the findings in Table 4.3 it is evident that the major source of the respondents enterprises' financing was the respondents' personal savings as shown by 51.2% while 48.8% of the respondents indicated that the major source of their enterprises' financing was the business ploughed back earnings. This agreed with Ayyagari *et al*. (2008) who noted that most of the SMEs rely on internal finance since they cannot easily afford external finance.

Table 4.3 also shows that majority (97.7%) of the respondents did agree that they considered financing as a leading constraint to their firms' growth while only 2.3% of the respondents did not consider financing as a leading constraint to their firms' growth. This implied that the

Vol. 1, No. 04; 2017

ISSN: 2456-7760

respondents were unanimous that financing was a major constraint to their firms' growth. This agreed with Dong & Men (2014) who noted that majority of the SMEs are strongly restricted in accessing the capital that they require to grow and expand, with over half of SMEs in developing countries rating access to finance as a leading constraint. This also agreed with Abor & Biekpe (2006) who in their study showed that SMEs not only perceive access to finance and cost of credit to be greater obstacles than large firms, but these factors constrain SMEs performance more than they do for large firms.

Table 4.3 further indicates that majority (62.8%) of the respondents' enterprises had received only 5% - 10% of funds applied for from the financial institutions, 27.9% had received 11% - 20% of funds applied for from the financial institutions, 7% had received less than 5% of funds applied for from the financial institutions while only 2.3% of the respondents' enterprises had received more than 20% of funds applied for from the financial institutions. This showed that the respondents' enterprises received only a small proportion of the funds they applied for from the financial institutions, further indicating reluctance of the financial institutions to lend to the SMEs. This agreed with Hongbo *et al*. (2009) who noted that most of the SMEs received far less amounts than applied for because from the banks' perspective monitoring SMEs is more difficult and expensive as information on them is less easily available, they have less credit history, are subject to less rigorous reporting requirements, lack adequate collateral and the quality of their financial statements may vary.

Regarding the major barriers to SMEs' access to funding from the financial institutions, the respondents indicated that some of the main barriers that their enterprises faced while seeking financing from the financial institutions included lack of collateral, high interest rates, unfavourable credit scoring methods, lengthy loan application procedures and need to file extensive documentation on their financial position. This implied that SMEs faced a wide range of constraints with regard to access to funding from financial institutions. This agreed with World Bank (2010) who noted that even though small and medium sized enterprises contributed more than 40% of World's GDP in 2009, they only got 13% of the lending capital due to lengthy lending procedures, corruption, poor lending policies, lack of collateral and costly interest rates. Similar findings were also found by Kimuyu and Omiti (2000) highlighted the reasons for SMEs' lack of access to credit from banks in Kenya as including inability to provide accurate information on their financial status, high interest rates charged on the bank loans, stringent lending terms and lack of adequate collateral required as security for the funds loaned.

4.2 Inferential Statistics

4.2.1 Correlation Analysis

A Pearson correlation analysis was used to assess the relationship between the study variables. The results are as illustrated in Table 4.4.

Table 4.4 Correlation Matrix

		Funding of SMEs	Ownership structure	Collateral	Ability to pay
Funding of SMEs	Pearson Correlation	1			
Ownership structure	Pearson Correlation	.361*	1		
	Sig.	.000			
Collateral	Pearson Correlation	.714*	.016	1	
	Sig.	.000	.114		

*Correlation is significant at the 0.05 level (2-tailed). N is 43

Results of the Pearson correlation as shown on Table 4.4 above indicates that there is a weak positive correlation between ownership structure and funding of SMEs ($r=0.361$, p value <0.05). This implies that an increase in ownership structure increases funding of the SMEs. Table 4.4 also shows that there is a strong positive correlation between collateral and funding of SMEs ($r=0.714$, p value <0.05) implying that increase in collateral held increases funding of the SMEs. Table 4.4 further shows that there is a strong positive correlation between ability to pay and funding of SMEs ($r=0.672$, p value <0.05) implying that an increase in ability to pay increases funding of the SMEs. In general, the findings indicate that there exists a positive correlation between ownership structure, collateral and ability to pay and funding of SMEs.

4.2 Tests of the Model and Data

4.2.1 Tests of Normality

Use of inferential parametric statistical procedures requires that the assumptions of such tests of normality are tested. This is to assist the graphical tests to be performed about the normality of the data to check for skewness and kurtosis coefficients. This tests help to confirm whether the data follows a normal distribution or not. If the normality is not achieved, the results may not depict the true picture of the relationship amongst the variables. In this study, normality was tested using Kolmogorov-Smirnov Test and the Shapiro-Wilk Test. The Shapiro-Wilk Test is more appropriate for small sample sizes (< 50 samples), but can also handle sample sizes as large as 2000. For this reason, this study used the Shapiro-Wilk test as our numerical means of assessing normality. If the Sig. value of the Shapiro-Wilk Test is greater than 0.05, (P-value test statistic) the data is normal. If it is below 0.05, the data significantly deviate from a normal distribution.

Table 4.5 Tests of Normality

Variables	**Kolmogorov-Smirnov**[a]			**Shapiro-Wilk**		
	Statistic	**df**	**Sig.**	**Statistic**	**df**	**Sig.**
Ownership structure [X_1]	.270	43	.184	.521	43	.312
Collateral [X_2]	.296	43	.184	.428	43	.312
Funding of SMEs [Y]	.255	43	.184	.574	43	.312
a. Lilliefors Significance Correction						

Table 4.5 above indicates that the significance values for the Shapiro-Wilk tests were 0.312 for ownership structure, collateral and funding of SMEs, each. For the Kolmogorov-Smirnov tests, the significance values were 0.184 for ownership structure, collateral, and funding of SMEs, each. This implies that since the p-value of Shapiro-Wilk tests and Kolmogorov-Smirnov tests were greater than the chosen alpha level of 0.05 then we accept the hypothesis that the data came from a normally distributed population. The results of the tests are therefore of a normally distributed population.

4.2.2 Heteroskedasticity

Heteroskedasticity occurs when the variance of the error terms differ across observations. Heteroskedasticity is useful to examine whether there is difference in residual variance of the observation period to another period of observation (Godfrey, 1996). The study utilized Glejser (1969) test conducted by regression residual value of the independent variable. In this case there is an assumption that if the Sig. value >0.05, then there is no problem of heteroskedasticity. The results for heteroskedasticity tests were as shown in Table 4.6.

Table 4.6 Test for Heteroskedasticity

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.482	.154		9.623	0.000
Ownership structure[X_1]	.132	.114	.159	0.567	0.102
Collateral [X_2]	.039	.021	.208	0.218	0.364

a. Dependent Variable: Funding of SMEs

Based on the coefficients of the three study variables (ownership structure and collateral) being tested for Heteroskedasticity, the obtained Sig. values are >0.05, thus there is no problem of heteroskedasticity. Hence, there is no difference in residual variance of independent to dependent variables tested.

4.3 Regression Analysis Results

The results of the regression analysis are as shown in Table 4.7.

Table 4.7Regression analysis results

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	4.103	.712		5.763	.000
Ownership structure	0.373	.153	0.138	2.438	.021
Collateral	0.716	.242	0.586	2.959	.006

From the results in Table 4.7 above, the regression equation became;

$$Y = 4.103 + 0.373\ X_1 + 0.716\ X_2 + \varepsilon \text{………………………………eqn. 4.1}$$

From equation 4.1 above, holding ownership structure [X_1] and collateral [X_2] to a constant zero, funding of the SMEs would be 4.103. A unit increase in ownership structure would lead to a 0.373 increase in the SMEs' funding while a unit increase in collateral held would lead to a 0.716 increase in the SMEs' funding. This implied that both ownership structure and collateral had a positive relationship with the funding of the SMEs.

There is a fairly positive relationship between ownership structure (that is, a change from sole proprietorship to a limited liability company) and funding of the SMEs ($\beta=0.373$, p value <0.05). This implies that a change in ownership structure of the SME from sole proprietorship to a corporate firm would increase funding of the SME by 0.373 units. This agreed with Huyghebaert (2009) who argued that lack of legal status which is independent with the owner of the business, meant that the loaned funds to the SMEs could be applied in other non-business activities by the SME owner in turn increasing the default risk associated with such funds. For this reason, banks impose higher financing costs and strict repayment terms on SMEs' financing which in turn greatly curtails their access to bank funding.

There is a significant positive relationship between collateral and funding of the SMEs ($\beta=0.716$, p value <0.05). This showed that a unit increase in collateral values would increase funding of the SMEs by 0.716 units. This is consistent with Osano and Languitone (2016) who found there is a significant relationship between the value of collateral held and financing of SMEs by the financial institutions.

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

5.1.1 Ownership structure and funding of the SMEs

The study established that privately held firms were likely to use more flexible financing instruments without others taking control in the company and that lack of legal status means that the loaned funds to the SMEs could be applied in other non-business activities in turn increasing the default risk associated with such funds making banks to impose higher financing costs and strict repayment terms on SMEs. Further, the study established that lack of separation between the firm and the owner affected the financing of SMEs and also that incorporated firms have higher growth than unincorporated firms which is an advantage to them in sourcing financing Regression analysis showed a fairly positive relationship between ownership structure and funding of the SMEs, implying that incorporation increases the SMEs' access to external funding.

5.1.2 Collateral and funding of the SMEs

The study revealed that the respondents did agree that the higher the value of assets, the lower the interest rates of the debt to be secured by those assets. The study also established that the requirement of collateral is a crucial aspect for SMEs to succeed in accessibility of external financing from lenders as the collateral serves as the insurance that the lender's contract will be honored and respected and that majority of the small scale business firms received loans that were far much less than requested for due to lack of adequate collateral. Further, SMEs with low tangible assets find it difficult to access bank financing due to their inability to pledge acceptable collateral. Regression analysis results showed a significant positive relationship between collateral and funding of the SMEs implying increase in collateral values increases the SMEs' access to external funding.

5.2 Conclusions and Recommendations

The study concluded that incorporation is associated with increased access to external funding given that incorporated firms have the ability to issue stock and their stockholders have the freedom to resell their stock. This ability facilitates their process of accessing external finance for expansion. Further, the study concluded that collateral requirement significantly curtailed SMEs' efforts of access credit from the financial institutions as collateral provides an incentive to repay and can be used to offset losses in case of default. The study recommends that the owners and managers of the SMEs should consider incorporation of their firms to increase their funding sources to issue of stocks. Further, incorporation would imply that the SMEs are able to benefit from adherence to strict financial reporting provisions and attain independent legal status which would in turn enhance their chances of accessing more external funding. The study further recommends that SMEs should strive to own more tangible assets that can create higher value on their firms to accelerate borrowing security since the higher the value of assets the lower the interest rates of the debt to be secured by those assets.

REFERENCES

Abdesamed, K.H., & Wahab, K.A. (2014). Financing of small and medium enterprises (SMEs): Determinants of bank loan application. *African Journal of Business Management*, *8*(17), 1.

Abor, J., & Biekpe, N. (2006). Small business financing initiatives in Ghana. *Problems and Perspectives in Management*, *4*(3), 69-77.

Agostino, M. (2008). Effects of screening and monitoring on credit rationing of SMEs. *Economic notes*, *37*(2), 155-179.

Aris, N.M. (2007). SMEs: Building blocks for economic growth. *Department of National Statistics, Malaysia*.

Baskin, J. (1989). An empirical investigation of the pecking order hypothesis. *Financial management*, 26-35.

Beck, T., Demirgüç-Kunt, A., & Martinez-Peria, M.S. (2008). Banking SME around the world: Lending practices, business models, drivers and obstacles. *World Bank. Mimeo*.

Carpenter, R.E. and Petersen, B.C. (2002). Is the Growth of Small Firms Constrained by Internal Finance? *Review of Economics and Statistics, 84(2)*: 298–309

Central Bank of Kenya, CBK (2013). *Financing of SMEs in Kenya*. Government Press

Coleman, S. (2010). Access to capital and Terms of credit: A comparison of men and women owned small businesses. *Journal of Small Business Management*, 38 (3): 37-52

Deakins, D., Whittam, G., & Wyper, J. (2010). SMEs' access to bank finance in Scotland: an analysis of bank manager decision making. *Venture Capital*, *12*(3), 193-209.

De la Torre, A., Pería, M., & Schmukler, S. (2010). Bank involvement with SMEs: Beyond relationship lending. *Journal of Banking & Finance*, *34*(9), 2280-2293.

Dong, Y., & Men, C. (2014). SME financing in emerging markets: firm characteristics, banking structure and institutions. *Emerging Markets Finance and Trade*, *50*(1), 120-149.

Fatoki, O., & Smit, A. (2011). Constraints to credit access by new SMEs in South Africa: a supply side analysis. *The African Journal of Business and Management*, *5*(4), 1413–1425.

Ferrando, A. and Griesshaber, N. (2011). "*Financing Obstacles among Euro Area Firms: Who Suffers the Most*?". ECB Working Paper Series No 1293, available at: http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1293.pdf (accessed 23 March 2015).

Gebru, G.H. (2009). Financing preferences of Micro and Small Enterprises owners in Tigray: Does POH hold? *Journal of Small Business Enterprises Development*, 16(2): 322-334

Hall, B.H. (2010). The Financing of Innovative Firms. *Review of Economics and Institutions*, 1 (1), 1–30

Haron, H., Said, S. B., Jayaraman, K., & Ismail, I. (2013). Factors Influencing Small Medium Enterprises

Hongbo, D., Xiaojie, H., & Hongbo, Y. (2009). "An Analysis of Causes for SME's Financing Difficulty". *International Journal of Business Management,* 4(6), 73-75

Hossain, M.M. (2014). *An Analysis of the Enabling Environment for SME Finance* (Doctoral dissertation, Eastern Mediterranean University (EMU)-Doğu Akdeniz Üniversitesi (DAÜ)).

Huyghebaert, N. (2009). "Financing of Business Start-ups: A Topic of Great Relevance for Firm Performance, Growth and Survival", in Balling, M., Bernet, B. and Gnan, E. (Eds.), Financing SMEs in Europe, SUERF Studies, Vienna, pp. 19–35.

Jensen, M.C., & Meckling W.H. (1976). Theory of the firm: managerial behavior, agency cost and ownership structure. *Journal of financial Economics*, 3(4), 305-360

Kimuyu, P., & Omiti, J. (2000). *Institutional impediments to access to credit by micro and small scale enterprises in Kenya* (Vol. 26). Nairobi: Institute of Policy Analysis and Research.

Kinyua, A.N. (2014). Factors Affecting the Performance of Small and Medium Enterprises in the Jua Kali Sector in Nakuru Town, Kenya. *Journal of Business and Management*, 6 (1), 5-10.

Lee, N., Sameen, H., & Cowling, M. (2015). Access to finance for innovative SMEs since the financial crisis. *Research policy*, *44*(2), 370-380.

Muguchu, M. (2013). Relationship between access to credit and financial performance of SMEs in Nairobi, Kenya. *Unpublished Thesis*, University of Nairobi

Muiru, M., & Kamau, S.M. (2014). An Assessment of financing challenges faced by Small and Medium Enterprises in Kenya, *Research Journal of Finance and Accounting*, 5(15), 20-27

Nondi, A. & Achoki, G.O. (2006). Finance Management in Small Hotels and Restaurants in Kenya. Paper presented at the 11th Annual International management Conference, March 28-31, 2006, Entebbe Uganda. Makerere Business Journal Occasional Paper, 18.

Olawale, F., and Garwe, D. (2010). Obstacles to the growth of new SMEs in South Africa: A principal component analysis approach. *African journal of Business management*, *4*(5), 729

Osano, H. M., & Languitone, H. (2016). Factors influencing access to finance by SMEs in Mozambique: case of SMEs in Maputo central business district. *Journal of Innovation and Entrepreneurship*, *5*(1), 1.

Pandula, G. (2011, February). An empirical investigation of small and medium enterprises' access to bank finance: The case of an emerging economy. In *Proceedings of ASBBS Annual Conference* (Vol. 18, No. 1, p. 18).

Sacerdoti, E. (2005). Access to bank credit in sub-Saharan Africa: key issues and reform strategies.

Tagoe, N., Nyarko, E., and Anuwa-Amarh, E. (2012). Financial challenges facing urban SMEs under financial sector liberalization in Ghana. *Journal of Small Business Management*, 43 (3): 331-343

ISSN: 2456-7760

Wang, Y. (2004). Financing difficulties and structural characteristics of SMEs in China. *China & World Economy*, *12*(2), 34-49.

Wanjohi, M.A. **(**2009).*Challenges Facing SMEs in Kenya*,Retrieved from http://www.buzzle.com/articles/challenges-facing-smes-in-kenya.html

Yusof, S., & Aspinwall, E. (2010). Critical success factors in small and medium enterprises: survey results. *Total quality management*, 11(4-6), 448-462