

Analysis of the Influence of Firm's Growth on the Financing Structure among Youth-owned Small and Medium Size Enterprises in Kiambu County, Kenya

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doi.org/10.51505/IJEBMR.2023.71105 URL: <https://doi.org/10.51505/IJEBMR.2023.71105>

Received: Oct 21, 2023

Accepted: Oct 31, 2023

Online Published: Nov 13, 2023

Abstract

Small and Medium Enterprises (SMEs) play a vital role in the economic landscape, with their financial stability being crucial for their survival and growth. The availability of capital, especially during phases of product and process innovation, is a pivotal factor that determines the trajectory of SMEs. Kiambu County in Kenya has emerged as a region witnessing notable growth in SMEs, particularly among young entrepreneurs who own a substantial number of these enterprises. This study aims to investigate the impact of firm growth on the financing structure of youth-owned SMEs in Kiambu County, Kenya, drawing upon the trade-off theory as its theoretical framework. Employing both explanatory and cross-sectional research designs, this study adopted linear regression analysis to explore the relationships between key variables. The findings reveal that most SMEs in the region exhibit high levels of product and service development, indicating growth in their ability to provide unique offerings. However, when it comes to ICT and financial innovation, the majority of these SMEs lag behind. Moreover, the study indicates a significant increase in the overall employee count, suggesting overall growth within these enterprises.

Keywords: Small and Medium Enterprises, firm growth, Financing structure, Financial innovation.

Introduction

Background of Research

Small and Medium Enterprises financing forms the most important factors of a firm's survival. Availability of capital at various phases of product and process innovation determines the growth of any Small and Medium Enterprises business. Access to capital is also critical since it allows a company to establish a viable service and product mix for a certain niche market. There are two types of SME financing: equity and debt finance. In this scenario, equity refers to the owner's money, whereas debt financing includes bank loans, trade credits, and leases, among other things (Asad, Shabbir, Salman, Haider & Ahmad, 2018).

Small and Medium Enterprises in Brazil rely largely on credit and cash flow for funding, because of their small-scale sizes, un-diversification, and insufficient structures in financing, they suffer

borrowing limits. Small and medium-sized firms (SMEs) face greater debt constraints than larger companies, resulting in reduced productivity (Ali et al, 2021). Signs of trouble for small businesses include delayed payments on receivables, a decrease in liquidity, and a rise in the number of small businesses going bankrupt. Aside from pricing signals that make SMEs unappealing borrowers, businesses find it difficult to regularly furnish high-quality collateral or to maintain creditworthiness transparency (Woldehanna, Amha & Yonis, 2018).

Many policymakers in Sub-Saharan Africa (SSA) have been concerned about the need to support the creation and growth of SMEs for two reasons. To begin, SSA's small and medium businesses must expand and evolve into thresholds where they can implement efficient production processes in order to effectively meet and attain the global competition. The SSA Small and Medium Enterprises sector has been labelled the "Missing Middle" in terms of financial integration or getting access to financial products and services, including banks (Quartey, Turkson, Abor & Iddrisu, 2017).

Ullah (2020) conducted a study in 28 countries across Eastern Europe and Central Asia examining the obstacles and dynamics faced by Small and Medium-sized Enterprises (SMEs) in transitional economies. The study specifically looked into financial constraints, corruption issues, and growth prospects. The growth of an SME is centered around overcoming two major challenges: being new to the market and operating on a limited scale. SME growth can take different forms, such as increased output, sales, and exports, as well as qualitative improvements in size and product/service quality.

There are several ways to measure the growth of small and medium-sized enterprises (SMEs), such as market share, assets, revenue, tangible results, employment generation, and available resources. Another important aspect in SME finance is the use of collateral obligations. These obligations involve borrowers pledging their assets as security for loan repayment (Ullah, 2020). This serves as a safety net for lenders, who have the right to seize these assets if there is a default on the loan. In particular, small businesses often offer tangible assets as collateral to secure loans. These assets need to be easily sold at a fair price within a reasonable timeframe in order to protect the lender (Ullah, 2020). This intricate relationship between financial and operational factors highlights the various challenges that SMEs encounter in economies undergoing transition.

Financial Structure of Small and Medium Sized Enterprises

Financial structure of SME's refers to available sources of finance that Small and Medium Enterprises use to finance its operations. Examples include short term debt, short term liabilities and equity capital. Financing structures are connected to oversight, legislation, and monitoring of the systems used by financial institutions and businesses to manage finances, such as payments. These financial institutions aid in the institutionalization of sound financial practices, resulting in greater stability and continuity (Olakunle & Jones, 2014).

The two most popular types of financial structures are debt and equity. Debts are quantities of money borrowed that must be paid back over a specified period, plus interest. Investing in equity, on the other hand, is done to get a share/ownership position in a firm, and the profits are

mostly dependent on the advantages. Small businesses can be sponsored internally as well as outside. Investment gains, asset sales, extended payment periods, cash flow decrease, and accounts receivable are all examples of internally generated cash (Abbasi, Wang & Abbasi, 2017).

Small and Medium Enterprises in Africa are, by their very nature, unable to offer the necessary security for traditional banking sector loans while also being too big to gain from microfinance credit and other types of financial assistance. One of the most frequent outside sources of funding for small businesses. According to Domeher, Musah and Hassan (2017), 6.3% of SMEs in Sub-Saharan Africa Ghana obtained external financing in the form of equity, 48.5% in the style of formal debt from abroad, 17.4% in the form of semi-formal funding, and 27.8% in the form of informal financing.

Youth Owned Small and Medium Sized Enterprises in Kiambu County

There are various SMEs in Kiambu County owned by the youths that belong to different sectors such as manufacturing, agriculture, and essential services like hospitals, schools, among other businesses, general merchandise includes stores, small supermarkets, and commercial products and services (Maina, 2020). Youth-owned SMEs in Kiambu County are growing at the fastest rate. For instance, according to Kiambu County Integrated Development Plan 2018-2022, as of 2021 there were 2647 registered SMEs in Kiambu County when the study was being conducted. The youth-owned SMEs are grouped into different sectors which include; manufacturing, services, trade, agriculture, hawkers and informal traders, general merchants and kiosks, and transport (Kiambu County, 2021).

More than half of the small businesses owned by young people in Kiambu county stop operating between the first six months of operation, according to a new study. SMEs face a variety of challenges that impede their progress, sustainable expansion, and economic development (Wanjau, 2017). A majority of the young SME operators in Kiambu County lack adequate funding according to a study by Bunyasi (2015).

Problem statement

Small and Medium-sized Enterprises (SMEs) have a crucial function in Kenya's economy by contributing to employment opportunities and poverty reduction. These enterprises, which account for about 85% of the small sector firm employment, create approximately 6.9 million jobs (Aberi & Jagongo, 2018). Among the regions experiencing remarkable SME growth is Kiambu County, where young entrepreneurs own a significant number of these businesses. Despite various financial schemes designed to support them, such as the youth and women fund and Uwezo fund, SMEs in Kenya, particularly those led by young individuals, still face significant performance challenges. Research conducted by Aberi and Jagongo (2018) reveals that approximately 60% of new businesses fail within their first year, and a staggering 40% of the remaining businesses don't make it past their second year. There are numerous factors contributing to this high failure rate, including mismanagement of debt, inadequate legal frameworks, limited coordination and implementation efforts, and restricted access to financial resources. Another study conducted by Mollo (2017) focused on youth-owned SMEs in Ongata-Rongai, Kenya, specifically examining their access to M-Shwari financial services and its impact

on investment, performance, and employment. The research findings showed that despite government assistance through financial literacy programs, youth-owned SMEs encountered significant challenges in terms of survival and performance.

In Kiambu County, where there is a high concentration of SMEs owned by young people, there is a lack of understanding regarding the impact of specific factors like firm growth on the financing structure of these businesses. This knowledge gap is particularly significant because the financial structure, which involves finding the right balance between debt and equity, plays a crucial role in increasing the overall value of a business while minimizing the cost of financing (Aberi & Jagongo, 2018). Despite its importance, there are limited studies that thoroughly examine how firm growth interacts with the financing structure of youth-owned SMEs in Kiambu County or Kenya as a whole.

To shed light on this issue, the study examined how firm growth impact firm's financing structure. Specifically, we focus on Small and Medium Size Enterprises (SMEs) owned by young entrepreneurs in Kiambu County, Kenya.

Objective of the Study

This study sought to determine the influence of firm's growth on the financing structure among youth-owned Small and Medium Size Enterprises in Kiambu County, Kenya.

Research Hypothesis

H0: Firm growth has no significant effect on financing structure among youth-owned Small and Medium Size Enterprises in Kiambu County, Kenya.

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Literature Review

Firm's Growth and Financing Structure

Firm's Growth is the expansion and scaling up of small and medium-sized businesses. Over time, business valuation increases as a result of an increase in assets or investment. The SME's ability to get external funding is a possible obstacle to expansion because it affects the business's leverage. Additionally, any SME that is continuously growing tends to have a positive rating and especially if it is involved in external borrowing and thus making it to have wider options in terms of financing which is key to its financial structure management (Neneh & Van, 2017).

Di Cintio, Ghosh and Grassi (2017) in their study have made the argument that the growth of the SMEs is linked to the short-term leverage that they have. They also contend that the cost for funding has decreased in terms of immediate leverage. On the other hand, if there is a conflict that will arise in terms of equity and debt then there is the possibility that there will be negative effects on the SMEs and their ability to manage their financing options.

Applying pecking order arguments, Ali, Ahmed, Tisha and Islam (2021) revealed that SMEs that are growing are keen on using internal sources of funding based on availability. On the other hand, SMEs that are experiencing growth will have various external options when it comes to

financing. Thus, they view the long-term debts as being secured and also having the ability to finance its operations within the market.

Theoretical Review

Trade-Off Theory

Modigliani and Miller were the creators of this theory in 1958. This theory explains how a corporation decides how much debt as well as how much equity should be used by considering the costs and advantages and balancing them out. This idea is essential because it explains why company units are typically financed partially with debt and partially with equity. The idea demonstrates that debt has advantages, such as tax benefits, but it also has disadvantages, such as costs of financial hardship, such as debt bankruptcy fees. As debt grows, the proportional advantage of any increased debt drops, whereas the marginal cost rises.

According to Myers (1984), the benefits and costs of indebtedness should be factored into the firm's target capital. The goal is determined by comparing the benefits of debt tax exemptions with the risks of bankruptcy. This idea is significant because it aids finance managers in making sound judgments when financing a business, ensuring that the advantages of debt outweigh the costs. This hypothesis implies that any company can only take on a certain amount of debt. The trade-off theory's empirical relevance has been questioned. If this theory is correct, corporations in the actual world should have far larger debt levels than we see in reality, according to Myers (1984). Large companies have a wider range of activities, which means they are less likely to go bankrupt. Large corporations tend to grow their debt levels in order to enhance their debt tax shields, according to the trade-off method.

The study and theory are connected in that the study is looking at the financing structure of the youth owned SMEs. The theory indicates that businesses always consider the amount of debt and equity that the business should be involved in. The study captures the firm growth rate, firm and collateral which are key determinants of the amount of debt that the business can get involved in. For instance, the owner of youth owned SME will look at the debt that they want to get into and the collateral as a trade-off to be used to secure a loan.

Methodology

This study employed the use of both an explanatory and a cross-sectional study design. Understanding the why as well as the means of a circumstance or phenomenon is the goal of explanatory studies (Kihara, 2016). The goal is to assess the strength of the relationship between variables (Sekaran & Bougie, 2013). By using linear regression analysis, the study examined the connections between study variables in a cross-sectional study design, as long as there is a significant sample size. In order to achieve a high response rate, it also provides more financial and time flexibility and avoids the hassle of looking for respondents repeatedly (Kothari, 2014).

The intended audience consisted of Kiambu County-registered young SME owners who also managed and ran their businesses on a daily basis. According to Kiambu County (2021) data from the Trade, Tourism, and Industries & Enterprise Development department, there were 2855 registered youth based Small and Medium Enterprises in Kiambu County as of 2021 when the

study was being conducted. The youth owned Small and Medium Enterprises were grouped into different sectors which includes manufacturing, services, trade, agriculture, hawkers and informal traders, general merchant and kiosks and transport (Kiambu County, 2021).

The computations for sample size adopted Yamane and Taro (1973), as illustrated below. Yamane and Taro (1973) formula calculated the overall sample size.

$$n = \frac{N}{1 + N(e)^2}$$

Such that;

n: Sample number

N: Population

e: Margin of error, at ±1%.

$$n = \frac{N}{1 + N(e^2)} = \frac{2855}{1 + 2855(0.1^2)} = 96.994 \cong 97$$

The sample size was 97 respondents.

Within the strata, the proportional allocation was employed to capture the different sectors of entrepreneurs. Cochran (1977) formula for proportional allocation (Kotrlík & Higgins, 2001) below:

$$n_i = \left(\frac{n}{N} \right) N_i$$

Where

n: Sample size from the first formulae

N: Sample population from the first formulae

n_i is the sample size from stratum i.

N_i is the target population for stratum i.

The target population of SMEs per sector was stratified into manufacturing, services, trade, agriculture, hawkers and informal traders, general merchants and kiosks and transport.

Research Findings

Response Rate

Research Instrument	Duly filled	Unfilled	Expected Count
Questionnaire	87(90 %)	10(10%)	97 (10%)

Source: (Survey data, 2023)

After the data collection was complete, we started the data analysis by classifying the responders and non-respondents. The study had a 90% response rate. This represents a response rate of 90% that is adequately satisfactory to allow for further data analysis (Saunders, Sivo, Chang & Jiang, 2016). A response rate of 50 per cent is adequate, 60 per cent is good, and 70 per cent is

excellent (Mugenda & Mugenda, 2003; Saunders et al., 2019). Hence, the response rate of 90% is excellent and acceptable for analysis of the study.

Descriptive Statistics on Growth of SMEs Products and Services Expansion

Products and services expansion	Frequency	Percentage
Very Low	8	9.3
Low	7	8.2
None	18	20.6
High	42	48.5
Very High	12	13.4
Total	87	100.0

Source: Researcher (2023)

According to the findings, 9.3% of organizations have very low development rates for products and services thus developing at a very slow rate. 8.2% had low product and service development, 20.6% had no product and service development. 48.5% had high product development while 13.4% had very high product and service expansion. As a result, the outcomes can be viewed to indicate that there is generally a high product and expansion development when it comes to the SMEs that took part in the study.

Information Communication Technology and Financial Innovation

ICT and Financial Innovation	Frequency	Percentage
Very Low	18	20.6
Low	41	47.4
None	8	9.3
High	20	22.7
Total	87	100.0

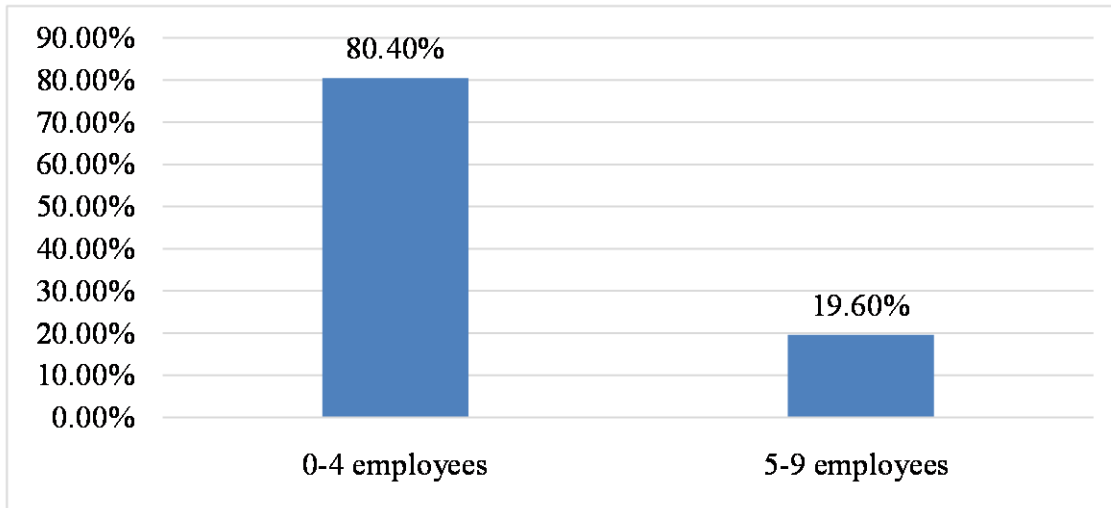
Source: Researcher (2023)

The results indicate that 20.6% of the SMEs have very low ICT and financial innovation. 47.4% have low ICT and financial innovation. 9.3% have no ICT and financial innovation. 22.7% have a high ICT and financial innovation. The study's findings can be construed to suggest that the majority of SMEs have limited ICT and financial innovation.

The use of ICT can boost business productivity by assuring the most efficient use of resources, reducing waste and electricity consumption, and providing a strategy to achieve profitable expansion possibilities from the point of view of management (Song & Wang, 2018). ICT applications, such as inventory management and procurement, can increase the economic feasibility of supply-chain operations, claim Bamfo et al. (2019). Mwangi and Cheluget (2018) also pointed out that financial innovation is responsible for 79% of the changes in SMEs' access to credit in Kenya. The report suggested making major efforts to support financing for SMEs.

Increase in number of Employees

The Figure indicates that 80.4% of the SMEs had an increase of 0-4 employees and 19.6% had an increase of 5-9 employees. Overall, it can be said that the SMEs have hired more people, indicating that their firms are expanding. Wach, Stephan, and Gorgievski (2016) found that over the course of three years, high-growth businesses in the UK witnessed an average job creation rate of three times. In 2005, the average high-growth business employed 60 employees; by 2008, that figure had increased to about 170.



Business Objectives

Business objectives	Frequency	Percentage
Business survival	9	10.3
Business status quo	10	11.5
Business expansion	44	50.6
Profit growth	24	27.6
Total	87	100.0

Form of business	Frequency	Percentage
Sole Proprietor	33	37.9
Partnership business	26	29.9
Family business	16	18.4
Limited Liability private companies	13	13.8
Total	87	100.0

Source: Researcher (2023)

The above table shows that, the most prevalent type of business among the surveyed youth-owned small and medium-sized enterprises (SMEs) is sole proprietorship, making up 37.9% of the total. Partnerships come next with 29.9%, followed by family businesses at 18.4%, and finally limited liability private companies at 13.8%. These findings indicate that most SMEs

prefer operating as individual ventures, possibly due to their simplicity in terms of management and setup. The high number of sole proprietorships in the business landscape carries implications for these enterprises. On one hand, their structure allows for easier decision-making. However, it may also limit their access to financial resources when compared to more intricate setups like Limited Liability companies. The prevalence of partnerships and family businesses, which represent almost half of all surveyed enterprises, could indicate a shift towards collaborative entrepreneurship. At the same time, it might signal challenges related to professional management and scalability. A comprehensive understanding of the distribution of these business forms is essential for targeted policymaking and support services. This approach considers the unique needs, opportunities, and challenges that each form presents.

Regression Analysis

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.146 ^a	.021	-.010	1.8145

a. Predictors: (Constant), Collateral, SME growth, SME Size

Source: Researcher (2023)

Based on the data presented in Table, the model used to analyze the financing structures of youth-owned SMEs demonstrates limited explanatory power. Specifically, the R-Squared value, which indicates how much of the variability in financing structures can be attributed to independent variables like Collateral, SME growth, and SME size, is just 0.021 or 2.1%. This suggests that a majority of approximately 97.9% of the variability is influenced by other factors not included in the model. Another concerning finding is that the Adjusted R-Squared value is -0.010, indicating that this model may not be reliable when applied to different samples or datasets. Furthermore, the relatively high Standard Error of Estimate at 1.8145 raises questions about the accuracy and precision of predictions made by this model. These results highlight the necessity for a more comprehensive approach that considers all relevant factors and better captures the complexities involved in understanding financing structures within youth-owned SMEs.

Model		ANOVA^a			F	Sig.
		Sum of squares	df	Mean Square		
1	Regression	6.705	3	2.235	.679	.567 ^b
	Residual	306.182	93	3.292		
	Total	312.887	96			

a. Dependent Variable: Financial Structure
 b. Predictors: (Constant), Collateral, Firm growth, Firm size

Source: Researcher (2023)

The findings show that the predictive model was not significant because the p-value was 1.8145 which is greater than 0.05.

Coefficients

Coefficients^{a v}

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	15.663	2.045		7.661	.000
Firm Size	.045	.093	.050	.483	.630
Firm Growth	-.074	.083	-.091	-.885	.378
Collateral	-.080	.082	-.102	-.976	.331

a. Dependent Variable: Financial Structure

Source: Researcher (2023)

The regression coefficients are fitted in the multiple regression whose results are as follows;

$$Y = 15.663 + 0.045X_1 - 0.074 X_2 - 0.080 X_3 + \epsilon$$

The financial structure will have a value of 15.663 if all components (firm size, firm growth, and collateral) are held constant at zero according to the equation for regression that has been created. The data analysis reveals that, when we keep all other factors constant, a larger firm will experience a slight increase in its financial structure by 0.045 units. On the other hand, a unit increase in firms growth will causes a decrease of 0.074 in financing structure. This is not an issue in that the firm may actually be seeking long term source of funds by becoming listed. The financing structure alternatives for SMEs will drop by -.080 for every unit increase in firm’s collateral. This may actually be a decrease in short term credit if the collateral is of high quality and acceptable to the lenders, such that the firm may actually go long term loans.

Hypothesis Testing.

H0: Firm’s growth has no significant effect on financing structure among youth-owned SMEs in Kiambu County, Kenya.

The study's hypothesis, H0, aimed to investigate the connection between firm growth and financing structure in youth-owned SMEs in Kiambu County, Kenya. Drawing on the Trade-Off Theory, which suggests that firms must weigh the advantages and disadvantages of debt and equity financing, firm growth becomes crucial. According to this theory, companies balance the tax benefits and flexibility of debt financing with the potential costs associated with bankruptcy. As rapidly growing firms seek to capitalize on emerging opportunities, they may turn to external

financing and thus have a distinct financing structure compared to stagnant or slow-growing firms. The regression equation reveals that the coefficient for firm growth (represented by X2) is -0.074. This negative value indicates that as a firm experiences growth, there is a slight decrease of 0.074 in its financing structure, assuming all other factors remain constant. Essentially, as companies expand, they may gravitate towards different financing options, potentially driven by long-term funding strategies or a preference for equity financing rather than short-term debt.

This finding provides an interesting perspective, indicating that growing businesses might be moving away from conventional debt structures. This could be due to their strategic objectives or a more positive market perception. It is worth noting that although this negative relationship was identified, the specific significance (p-value) pertaining to firm growth was not explicitly specified in the data provided. Therefore, while the negative coefficient offers directional insight, further statistical validation is required to ascertain the true significance of this relationship.

Previous research has offered insights that challenge existing norms. In a study by Kamar and Ayuma (2016), the focus was on the impact of institutional monitoring on loan recovery and how different mechanisms can enhance the retrieval process. Although their study did not specifically address firm growth, it highlighted the importance of structures and processes in achieving favourable financial outcomes. As a result, we could formulate a hypothesis that suggests growing companies with effective institutional checks may have distinct financing preferences. However, further research is needed to gain more clarity on this matter. To summarize, this study highlights a possible connection between firm growth and specific financing structures. However, further investigation and comparison with broader empirical studies are necessary to confirm these findings in the context of youth-owned small and medium enterprises (SMEs) in Kiambu County, Kenya.

Observation and Conclusion

The study findings indicate that 9.3% of the businesses have very low product and service development. 8.2% had low product and service development, 20.6% had no product and service development. 48.5% had high product development while 13.4% had very high product and service expansion. Accordingly, the results can be perceived to indicate that SMEs who participated in the study generally have higher levels of product development.

The study findings indicated that 20.6% of the SMEs have very low ICT and financial innovation. 47.4% have low ICT and financial innovation. 9.3% have no ICT and financial innovation. 22.7% have a high ICT and financial innovation. According to the study's findings, the majority of SMEs have little financial innovation or ICT use.

According to the study, the majority of small and medium-sized enterprises (80.4%) saw a growth in their workforce ranging from 0 to 4 employees. The remaining 19.6% experienced an expansion of 5 to 9 employees. Overall, it can be said that the SMEs have hired more people, indicating that their firms are expanding. The findings of the study indicates that 9.3% of the businesses are keen on business survival, 10.3% are after business status quo, 50.5% are after business expansion and 29.9% are aiming at profit growth. Thus, it can be concluded that most of the SMEs are after business expansion.

The survey findings suggest that 4.1% of the firms are not registered with Kiambu County, 33% are sole proprietorship, 29.9% are partnership businesses, 18.6% are family business and 14.4% are Limited Liability private companies-based businesses. Thus, the findings can be concluded that most of the businesses are sole proprietors.

Conclusion

The study examined the financial structures of youth owned SMEs in Kiambu County, Kenya, looking at the effect of firm growth on SMEs' financial strategy. Using a refined linear regression model, the study demonstrated an underlying linkage between firm development and longer-term funding as opposed to conventional loan. In line with the tenants of Trade-Off Theory, the outcomes show that there has been a strategic shift in funding after scale-up at the firm level.

Similarly, Kamar and Ayuma's (2016) study highlights the significance of these organizational frameworks, though only with regard to their impact on the decision-making process about financing, indicating an area for further explorations.

Future research may include in-depth investigations into the significance levels of the regression coefficients to further validate these results. Furthermore, taking this research further to cover other places would also be of interest to understand how institutional influences vary across regions. Also, researchers need to probe into the effect that financial literacy and innovations have on SMEs' financial decisions.

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