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Effect of Credit Rationing on Financial Accessibility by Small and Medium Enterprises in Eldama Ravine Sub – county, Kenya

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Abstract:

The micro, small and medium enterprises continue to play a critical role in the development process in developing economies. Due to their contribution, Small and Medium Enterprises development continue to be a key focus of in economic development initiatives since they have the ability to create employment and contribute to Gross Domestic Product growth. Access to credit has been cited as key impediment to Small and Medium Enterprises growth triggering many financial initiatives for the sector such as Microfinance as well as Small and Medium Enterprises lending in commercial banks. Furthermore, a fundamental problem has been the risk profile for Small and Medium Enterprises that has made it difficult for them to access credit through mainstream banks. Risk based lending continues to gain momentum in Kenya and as a result credit rationing for Small and Medium Enterprises is imminent. In attempting to gain access to financial services Small and Medium Enterprises continue to face constraints. Thus, this research intended to study the role played by credit rationing on financial accessibility by Small and Medium Enterprises in Eldama Ravine Sub-County in Baringo County, Kenya. A cross-sectional survey research design was used. Stratified random sampling technique was adopted to draw a sample of respondents from the accessible population. This study used a self-administered semi-structured questionnaire to collect data. A pre-testing of questionnaires was conducted before carrying out the main study. This study employed the Cronbach alpha coefficient to test the instrument's reliability. Content validity test was used for validity test. Data analysis captured both descriptive and inferential statistics. Descriptive statistics included modes, medians, means, standard deviations and variances. The results of the analysis were presented in form of tables, graphs and charts. From the findings, the study concluded that: firms with good credit history, older and large enterprises are not denied loans. The respondents further agreed that risky ventures are credit rationed by banks. In most cases firms that offer highly valued collaterals are not credit rationed. The results indicated with reduced credit rationing, financial institutions will ensure financial services are accessible to SME's. Majority of financial institution would prefer group lending compared to individual. This will have a positive impact on the performance of SMEs.

Keywords: Credit rationing, financial accessibility, small and medium enterprises

1. Introduction

Small and micro enterprises (SMEs) are important players in the Kenyan economy in the provision of goods and services, economic growth and social inclusion, thus it's a key Sector of the economy. A survey on the Micro and small enterprises in Kenya by the Kenya National Bureau of Statistics in 2016 indicated that the sectors output was estimated at KSh 3,371.7 billion annually in a national output of KSh 9,971.4 thus contributing 33.8 of the GDP in 2015. Furthermore, gross value added from the sector stands at KSh 1,780.0 billion against the national KSh 5,668.2. As at the end of 2015 the sector employed 14.9 million people therefore making it the highest employment sector in the economy.

The SME sector contribution to the economy is no doubt huge, however the MSME survey revealed that in a period of five years 2.2 million MSMEs closed down due to difficulties in operation. The main reason cited by entrepreneurs for closure of their businesses was shortage of operating funds, cited by 29.6 % of the closures (KNBS, 2016). The challenge to credit has been cited by other scholars such as (Chege, 2014). SMEs face a number of constraints, that make it difficult to access credit. They are also rated as high-risk borrowers in commercial banks.

The banking industry in Kenya has experienced tremendous strides over the past three decades has been operating under dynamic regulatory regime underpinned by market based pricing policy. This has significantly enables the SMEs to access credit through the mainstream banks. However, in 2016, the Central Bank of Kenya Introduced the interest rate capping and the emphasis of risk based lending. Since then the credit market has shifted significantly. In an interview, the CBK Governor admitted that that growth of credit to the private sector in 2017 experienced a significant drop since the introduction of interest caps and credit rationing. The SMEs were more affected.

1.1. Problem Statement

Accessing credit is a critical input to growth and development of the SME sector since majority do not have sufficient capital for operation and expansion as well. However, difficulty in access to credit has often plagued this sector into significant difficulty and failure. Most SMEs rely on the personal savings, and or loans from friends and relatives to fund the enterprises. Banks on the other hand remains highly liquid and reluctant to expand credit other than to most credit worthy borrowers which in most cases excludes the SMEs (Muguchu, 2013). In 2015, the government of Kenya through the Central Bank of Kenya implemented the interest rate capping policy which shifted the operations of the banking sector from market based pricing to risk based lending thus resulting to acute credit rationing to SMEs considered as high-risk borrowers. However, the impact of the credit rationing has not been adequately researched to determine the impact of SMEs especially in the rural areas. In this study, therefore the researcher sought to fill this gap by carrying out a survey to find out how credit rationing affected access to finance by of SMEs in Eldama Ravine Sub-County, Baringo County, Kenya.

1.2. Objective of the Study

To examine the effect of credit rationing on financial accessibility by SME's in Eldama Ravine Sub-County in Baringo County, Kenya.

1.3. Hypothesis

The relationship between credit rationing and financial accessibility by SME's in Eldama Ravine Sub-County in Baringo County, Kenya is not statistically significant.

1.4. Scope

The study was carried out between September, 2016 and June, 2017. The scope of this research was limited to SMEs which are registered in Eldama Ravine Sub-County, Single Registration Licenses (2016). The study laid emphasis on determinants of financial accessibility by SME's in Eldama Ravine Sub-County in Baringo County, Kenya. The number of SMEs have continued to increase and thus resulting to vibrant growth.

2. Methodology

2.1. Research Design

In respect to this study, a cross-sectional survey research design was adopted. Cross-sectional surveys are part of descriptive studies and sought to put into perspective the views of respondents participating in a study over a specific point in time or over a given period of time (Kothari, 2008). These attributes justify the choice of cross-sectional research design for this study.

2.2. Target Population

The target population for this study were all proprietors of the SMEs in Kenya. Accessible population refers to that population which is part of the target population and from which the sample is obtained (Kothari, 2008). Accessible population were 286 proprietors of SMEs in Eldama Ravine Sub-County in the County Government of Baringo.

2.3. Sampling Technique and Sample Size

In this study, all the 286 proprietors of SMEs in Eldama Ravine Sub-County in the County Government of Baringo constituted the accessible population. In view of this, a representative sample was calculated from the accessible population using Nassiuma's (2000) formula as hereby illustrated.

$$n = \frac{NC^2}{C^2 + (N-1)e^2} \quad \text{Where:}$$

n = Sample Size

N = Population Size

C = coefficient of variation ($21\% \leq C \leq 30\%$)

e = error margin ($2\% \leq e \leq 5\%$)

Substituting the equation:

$$n = \frac{286(0.21)^2}{0.21^2 + (286-1)0.025^2}$$

$$n = 56.8$$

$$n = 57 \text{ respondents}$$

This implies that the sample population constituted 57 proprietors of SMEs in Eldama Ravine Sub-County, Baringo County. Simple random sampling was used to obtain 16 respondents from proprietors of small enterprises and 41 from those of medium enterprises as shown in Table 1. This sampling method is necessitated by the fact that it ensures that there is fair and equitable selection of respondents from each of the groups of SMEs in Eldama Ravine Sub-County in the County Government of Baringo.

Group	Proprietors	Sampling size	Percentage (%)
1. Small Enterprises	80	16	28
2. Medium Enterprises	206	41	72
Total	286	57	100

Table 1: Sampling Distribution

2.4. Research Instrument

This study used a self-administered semi-structured questionnaire to collect data. Questionnaires are the most appropriate tools for collecting data in survey studies since it is possible to administer them on a relatively large number of respondents. The instrument was structured in a way that enabled collection of data that would objectively address all study variables. Secondary data was collected using data collection sheet. A pre-testing of questionnaires was conducted before carrying out the main study. The pilot study involved 10% the size of the sample (Kothari, 2004). This equaled to 6 respondents who were randomly drawn from Eldama Ravine Sub-County in the County Government of Baringo. The participants in the pre-testing were not involved in the final study. The main aim of pre-testing the research instrument is to ensure that it is both valid and reliable for data collection. Content validity was determined through expert opinion. Cronbach alpha coefficient was used to test for the reliability.

2.5. Data and Analysis

Before collecting data, consent of the University and that of the proprietors of the SMEs in Eldama Ravine Sub-County in the County Government of Baringo was sought. The questionnaires were issued to the respondents by the researcher in person. The entire period of data collection was anticipated to be about fourteen days. The data collected was analyzed using descriptive statistics and further relationship between credit rationing and access analyzed using Pearson correlation analysis.

3. Findings, Discussions and Conclusions

3.1. Background Information of Respondents and their Businesses

The study collected information pertaining the gender, level of education, duration of business existence, type of business, number of employees and business license and document among SME's in Eldama Ravine Sub-County, Kenya. According to the findings, 58% of the respondents were female while 42% of the respondents were male. This implies that majority of proprietors of SMEs in Eldama Ravine Sub-County were female.

3.2. Academic Qualifications of SME owner Managers

The respondents were asked to indicate their highest level of education. The findings were as shown in Table2.

	Frequency	Percentage
Primary	2	4%
Secondary	2	4%
College	35	73%
University	9	19%
Total	48	100

Table 2: Academic Qualifications

From the findings, 73% of the respondents indicated they had attained a college education, 19% stated they had attained university degree while 4% of the respondents indicated that they had attained primary and secondary education each. This shows that majority of the respondents had attained college education.

3.3. Experience in Business

The respondents were asked to indicate the duration their businesses have been in operation. The findings were as presented in Table 3.

Years	Frequency	Percentage
Less than 1 Years	2	4%
1-5 Years	19	40%
6-10 Years	13	27%
More than 10 Years	14	29%
Total	48	100

Table 3: Duration of Business Existence

According to the findings, 40% stated they had been operational for 1-5 years, 29% stated they had been operational for more than 10 years, 27% stated they had been operational for 6-10 years while 4% of the respondents indicated their businesses had been operational for less than 1 year. This shows that majority of the businesses had been operational for 1-5 years.

3.4. Nature of Business Operated

The respondents were requested to indicate the type of businesses they operate. The results were as shown in Figure 1.

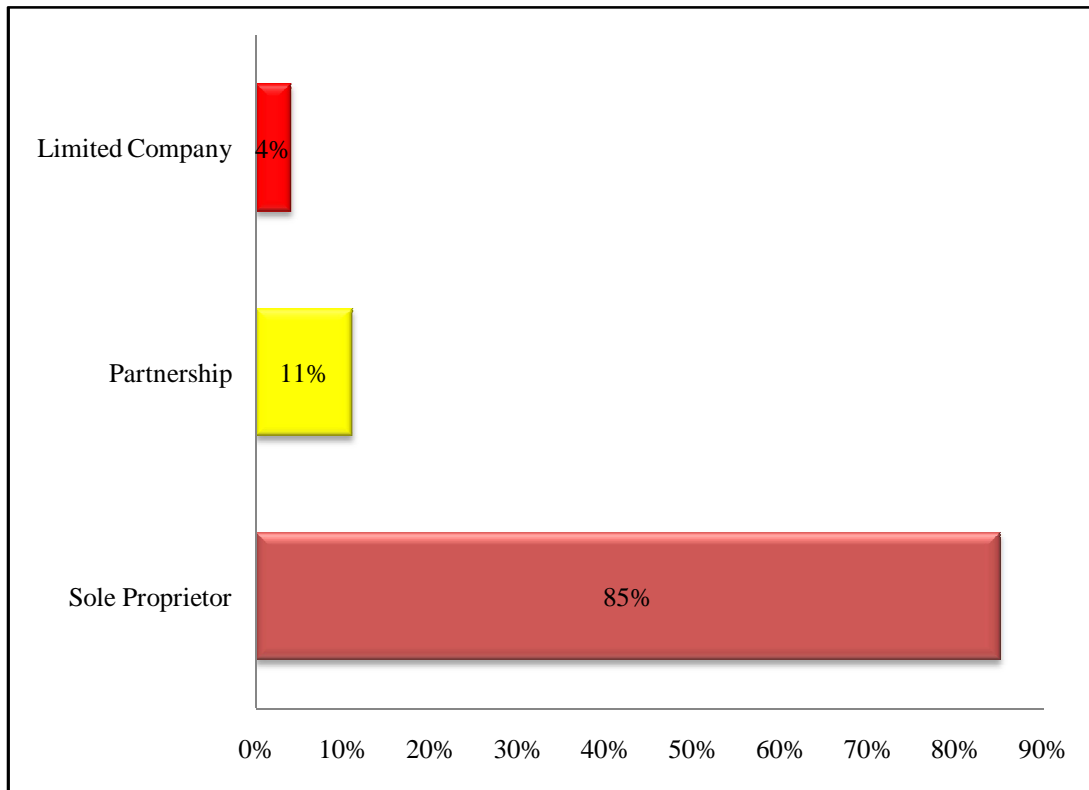


Figure 1: Nature of Business

According to the findings, 85% of the business in Eldama Ravine Sub-County are sole proprietorships, 11% are partnerships while 4% are limited companies. This implies that majority of the businesses in Eldama Ravine Sub-County are sole proprietorships.

3.5. Number of Employees

According to the findings, 83% of the respondents stated they had employed less than 10 employees, 9% of the respondents stated they had employed 10-50 employees, 6% of the respondents stated they had employed 50-100 employees while 2% stated that had employed 100-250 employees. This implies that majority of businesses in Ravine town had less than 10 employees.

3.6. Business Licences and Documents

The respondents were requested to indicate the various business licence they have. The results were as shown in Table 4

Business Licences and Documents	Frequency	Percentage
VAT Registration Certificate, County Council Single Permit, PIN Certificate, Tax Compliance Certificate, Annual Tax Returns and Monthly VAT Returns	32	41
VAT Registration Certificate, County Council Single Permit and PIN Certificate	33	43
County Council Single Permit	12	16

Table 4: Business Licences and Documents

From the findings, 43% stated they only have VAT Registration Certificate, County Council Single Permit and PIN Certificate, 41% of the businesses under study have all the licences and documentation (VAT Registration Certificate, County Council Single Permit, PIN Certificate, Tax Compliance Certificate, Annual Tax Returns and Monthly VAT Returns) needed to operate a business, while 16% of the respondents stated they only have County Council Single Permit. This implies that majority of businesses operating in Eldama Ravine Sub-County have all the licences and documents needed to operate a business.

3.7. Credit Rationing

The study requested respondents to give opinions in regard to credit rationing and financial accessibility among SMEs in Eldama Ravine Sub-County in the County Government of Baringo. The responses were on a scale of five points where 5, 4, 3, 2, and 1 represented strongly agree, agree, not sure, disagree, and strongly disagree respectively. The results were as shown in table 5.

	N	Min	Max	Mean	Std. Deviation
Older and large enterprises are not denied loans (credit rationed).	48	1	5	3.60	1.162
Firms with good credit history are not denied loans.	48	1	5	4.06	.998
Risky ventures are credit rationed by banks in most cases.	48	1	5	3.50	.945
Firms that offer highly valued collaterals are not credit rationed.	48	1	5	3.52	1.131

Table 5: Descriptive Statistics for Credit Rationing

From the findings, the respondents agreed that firms with good credit history are not denied loans (mean = 4.06; std dev = 0.998). They also agreed that older and large enterprises are not denied loans (credit rationed) (mean = 3.60; std dev = 1.162). They further agreed that risky ventures are credit rationed by banks in most cases (mean = 3.50; std dev = 0.945). The respondents also agreed that firms that offer highly valued collaterals are not credit rationed (mean = 3.52; std dev = 1.131). The findings of the study tallied with Namusonge, (2016) who states that borrowers deemed to be not creditworthy are denied loans completely (credit rationed).

3.8. Financial Accessibility

The study also sought to establish financial accessibility by SMEs. The results were as shown in table 6.

	N	Min	Max	Mean	Std. Deviation
Lack of collateral has led to poor access of credit by SMEs.	48	1	4	4.02	.729
Lack of awareness on funding opportunities has led to poor access to credit by SMEs.	48	1	4	4.10	.973
Large enterprises are likely to access credit easily compared to medium and small enterprises	48	1	5	4.15	1.031
Borrowers deemed to be not credit worthy are denied loans completely.	48	1	5	3.81	.938

Table 6: Descriptive Statistics for Financial Accessibility

Respondents admitted that large enterprises are likely to access credit easily compared to medium and small enterprises (mean = 4.15; std dev = 1.031). In addition, the respondents concurred that lack of awareness on funding opportunities has led to poor access to credit by SMEs (mean = 4.10; std dev = 0.973). It was also agreed that lack of collateral has led to poor access of credit by SMEs (mean = 4.02; std dev = 0.729). Finally, the respondents agreed that borrowers deemed to be not credit worthy are denied loans completely (mean = 3.81; std dev = 0.938). The study agreed with Kamunge et al. (2014) who indicated that there are various financial challenges that face small enterprises which include the high cost of credit, high bank charges and fees among others.

3.9. Relationship between Credit Rationing and Financial Accessibility

The study determined the relationship between credit rationing and financial accessibility by SME's in Eldama Ravine Sub-County by computing the Pearson correlation analysis between the two variables as shown in Table 7.

Credit Rationing	Financial Accessibility	
	Pearson Correlation	-0.566**
	Sig. (2-tailed)	.007
	N	48

Table 7: Correlation between Credit Rationing and Financial Accessibility

** Correlation is significant at the 0.01 level (2-tailed).

As indicated in Table 4.12 the relationship between credit rationing and financial accessibility by SME's in Eldama Ravine Sub-County is negative, moderately strong and significant ($r = -0.566$; $p < 0.01$). The results implied that as credit rationing increase financial accessibility reduces and the reverse was true. As such in order to ensure financial accessibility is enhanced financial institutions should reduce the credit rationing.

3.10. Conclusion

Regarding the effect of credit rationing on financial accessibility the study revealed that firms with good credit history, older and large enterprises are not denied loans. The respondents further agreed that risky ventures are credit rationed by banks. In most cases firms that offer highly valued collaterals are not credit rationed. The results indicated with reduced credit rationing, financial institutions will

ensure financial services are accessible to SME's. This should therefore mean that credit facilities being offered should not only be tied to firm's good history but also ability to service these credits.

The study concluded that borrowers deemed to be not creditworthy are denied loans completely (credit rationed). Risky ventures are credit rationed by banks in most cases. From the findings, the study further concluded that lending institutions consider the size of an enterprise while approving loan application.

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