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## Effect of Informal Financing Structure on Financial Performance of Women Owned Enterprises in Kenya: A Case Study of Gikomba Market

**Karenye Beatrice Njoki**

MB.A. Finance Student, Jomo Kenyatta University of Agriculture and Technology, Kenya

**Willy Mwangi Muturi**

Professor, Jomo Kenyatta University of Agriculture and Technology, Kenya

### **Abstract:**

*The main objective of this study was to investigate the effect of informal financing structure on financial performance of women owned enterprises in Kenya. The study covered rotating savings and credit associations (ROSCAs), trade credit financing, shylock financing and borrowing from friends and family as the specific objectives, guided by the Adverse Selection Theory, Financial Liberalization Theory, Credit Rationing Theory and the Altruistic Financing Theory. The study used a descriptive study and targeted 1000 registered women owned enterprises; sample size of 90 female entrepreneurs was used to provide primary data. A regression analysis was performed to show the significance of the relationship between study variables from the findings. This study found out that ROSCAs and trade credits have a positive effect on financial performance and recommends entrepreneurs to utilize these informal methods if they opt for the informal financing. Shylock financing was found unfavorable in financing business enterprise due to huge interest rates, provision of collateral and the non-impact on financial performance. Borrowing from friends and family though with zero interest rates, results to smaller amounts that are inadequate to finance business enterprises. This study recommends that this option can only be exercised if ROSCAs and trade credit fail.*

**Keywords:** *Informal financing structure, credit associations, trade credit financing, shylock financing, financial performance*

### **1. Introduction**

According to Itonga, Waweru & Huka (2016), despite the overall concept that women-owned businesses have attracted mass recognition and appreciation, there has been an exemption into the Kenyan perspective. According to Ndiritu (2011) most of the women-owned businesses have continued to perform poorly, a trend which can be attributed to factors such as financial illiteracy, high poverty levels, and most important lack or inadequate to credit extension through the conventional ways. In addition, approximately 60% of women-owned SMEs locally can be traced to lack of continuity in stock levels which greatly impacts on their performance and sustainability. Therefore, timely acquisition of proper and sufficient finance is a prerequisite for existence and performance of all business ventures and it is this trend which has continuously been seen as an important development metric responsible for widespread economic development. However, access to finances and credit has been the main challenge attributed to dismal performance of women owned enterprises. For instance, commercial banks have denied women credit facilities on the account that they do not have collateral and that they are a big risk to invest in. This outlines the reason why most of women entrepreneurs have resulted into informal sources of finance to start and expand their businesses enterprises (Muturi, 2012).

Recently, the finance literature has channeled its focus on the strength and type of the correlation between acquisition of the finance and the financial performance of small and medium enterprises both at the local and international perspectives. However, different researchers have approached this study area differently and the results have been different though the existing literature supports the relationship between the two variables. There is extensive research based on different concepts for instance the relationship between financial and non-financial options and how they affect performance of small and medium enterprises (Wachira, 2012). In accordance with previous literature, measuring and creating a proper definition for the performance among the small and medium enterprise is a terrific test given their nature of operations, size and the atmosphere in which they function. However, according to Harash, Al-Timimi & Alsaadi, (2014) most of the performance definitions created by researchers have connected performance with the overall results of a company achieved through the interventions that it incorporates in order to achieve the marketing and financial goals.

According to Itonga *et al.*, (2016) performance of women owned enterprises can be measured by observing variables such as the number of women owned businesses, increase in profit levels changes sales turnover, the number employees engaged, increase in service levels and production, and increase in total business capitalization. There is a

noteworthy increase in women self-employment, with more women now opening up new businesses thrice the rate of male counterparts. Women participation in income-generating projects and self-employment has received considerable attention though they perform more poorly than male-owned enterprises. Most women owned enterprises are smaller in size and are located in poorer areas and all these factors can be used to determine the performance of these enterprises.

### 1.1. Statement of the Problem

In Kenya, the government, financial, microfinance institutions as well as other non-governmental institutions have made efforts to create policies and programs to help women entrepreneurs own, operate and grow business ventures. However, despite the efforts made past records are characterized by failures or early closures of women owned enterprises (Wanjohi, 2010). While Women entrepreneurs make significant contributions to their economies in the 21<sup>st</sup> century, they are faced with a myriad of nonfinancial and financial difficulties in actualizing their growth prospective. Numerous research studies have been conducted in regards to other sources of financing related to formal sources of funding and in respect to factors connected to the performance of small and medium business enterprises in general. Majority of the studies point out that funding and/or access to credit is critical for the operation of small and medium enterprises (Itonga et al., 2016; Maina, 2016; Muthoka, Ngui, & Joseph, 2016). The study by White, Maru & Boit (2015), for example, focuses on sources of finance as drivers of performance and the study by Maina, (2016) purposes to find out the role of lending practices among commercial banks in Kenya. However, there is very little research done in regards to informal sources of funding most especially in regards to women-owned SMEs and their performances hence creating a knowledge gap which this study intends to fill.

### 1.2. Objectives

- To assess the effect of Rotating savings and credit associations on financial performance of women owned enterprises in Kenya
- To establish the effect of trade credit financing on financial performance of women owned enterprises in Kenya
- To find out the effect of Shylock financing on financial performance of women owned enterprises in Kenya
- To assess the effect of borrowing from friends and family on financial performance of women owned enterprises in Kenya

### 1.3. Conceptual Framework

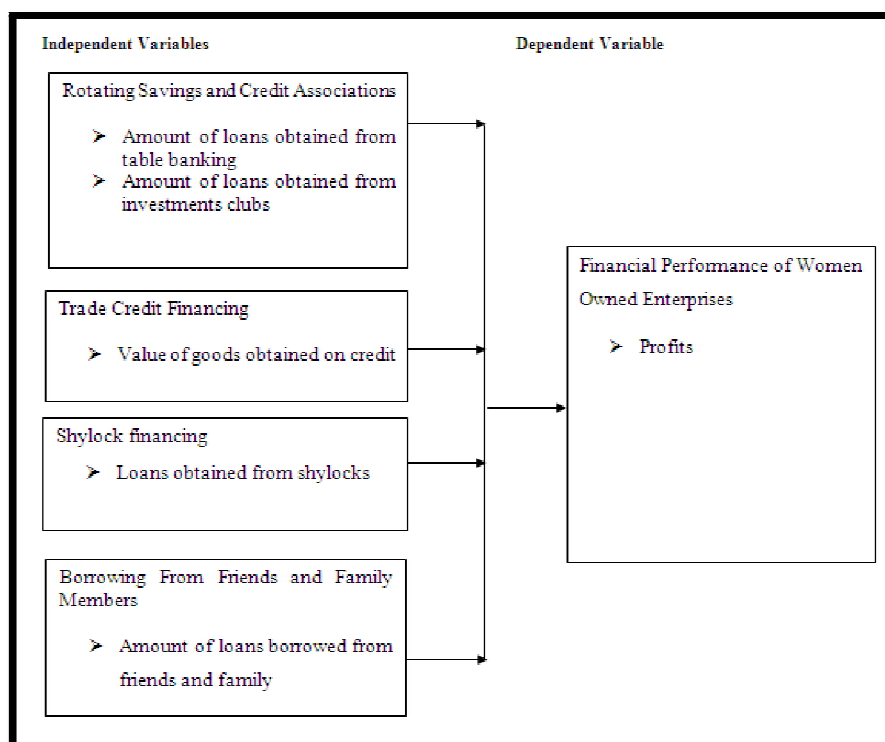


Figure 1: Conceptual Framework

## 2. Empirical Review

### 2.1. Rotating Savings and Credit Associations and Financial Performance

Previous research on informal financial sector in Kenya Studies has shown the popularity of roscas. For example, Kimuyu (1999) established that that between 45% and 50% of the respondents targeted in the study in Central Kenya were members to roscas. Secondly, a study done by Anderson and Baland (2002) found out that among a target of 57% of the households in Kibera slum, at least a family member belonged to a Rosca. In a different study by Similarly, Johnson

(2004) established that 49% of respondents in Central Kenya which was his case study were members to a Rosca to roscas while 9% belonged to autonomous Ascas and the remaining 6% to managed ascas. In addition, a study done in western Kenya revealed that rosca members in the region as well across the country, were more likely to be women and this explains the need to undertake this study to establish the relationship between Roscas and performance of women owned business enterprises in Nairobi city county.

### *2.2. Trade Credit Financing and Financial Performance*

In recent years, trade credit in among the small scale and medium enterprises has gained recognition. A major contribution to this scenario has been the need by the business owners to sustain business enterprises as well as ensuring they generate revenue. This kind of financing confirms the classically pattern of business records which are usually accounts payable and receivable which at times are difficult to maintain especially among the small and medium business owned by women where the goal is to generate revenue and not to adhere to strict rules on book keeping (Fernando & Mulier, 2012). Among most SMEs, trade credit tremendously provided capital to enable business operations and expansion. To the suppliers, SMEs owners' repayment of goods and services delivered on credit is in some circumstances better than cash sales since credit finance provides long term customers to the supplier with strong collaborative relationships.

Trade credit in small scale business is viewed as a suitable method for some reasons. First, the small business owners prefer the suppliers who offer this type of financing to the normal banks since no collateral is required and that the suppliers have adequate information about the customers so the transaction is fast and timely. Secondly, trade credit allows the borrowers' adequate grace period to undertake business and repay the suppliers later. This enables the business owners to effectively generate revenue from the "free goods and services" and pay once profit is generated. However, trade credit is can be seen as a discriminatory type of informal source of finance since the suppliers only provide the goods and services to clients they are familiar with hence some are denied the credit goods (Finlay, 2009).

### *2.3. Shylock Financing and Financial Performance*

According to Mungiru&Njeru (2015) a shylock loan is a type of informal loans extended by mostly business people who give loans to small scale borrowers at minimal interest rates. According to (Kihimbo, 2012) Shylock loans are commonly available in rural areas and urban informal settings and the terms of business are greatly influenced by the conditions given by the lenders. The transaction requires the borrower to provide of a guarantor or security in order to prevent the borrower form default the loans. According to Berg, Emran, & Shilpi, (2013) the borrower must provide a pledge, guarantor, and their land or in some cases both to serve as insurance before the allowance of the loan facilities. However, according to Muturi (2012) credit from shylock is regarded by most of the small scale borrowers as the most expensive credit available yet quick among the informal financial. This explains the reasons why the demand for shylock loans are avoided by most business people and will only be required as the last resort.

### *2.4. Borrowing from Friends and Family and Financial Performance*

The majority of informal or rural finance, in developing and developed and countries, is provided by friends or family members as loans or even gifts (Kapkiyai&Mugo 2015). According to Mungiru, &Njeru, (2015) the fact that finance from family members and friends is cheap and easily available but still not preferred by most women entrepreneurs suggests, that family finance comes with hidden costs as well as conditions and secondly, that this source may impose terms and conditions which may affect negatively the business ventures undertaken the entrepreneurs. In most of the developing countries, Kenya alike, great notion lies in the belief that financial help should be extended to immediate friends and family members specially to undertake income generating income activities. In contrast however, borrowing from family and friends can create unnecessary pressure to the entrepreneur, especially if the business venture runs down (Chioma&Ngozi, 2014). In addition to the family and friends source of finance entrepreneurs supplement with Personal savings which are also dominant source of credit, especially for initial capital. According to Macharia, (2012) most small scale enterprises use credit from relatives and friends which is a great source of finance to Medium and small firms in Kenya. In his study Macharia, (2012) established that family and friends played a big role in assisting the SMEs owners enhance their business operations with an average of 40% of the finances coming friends and family members, and approximately 24% came from financial institutions approximately 30% of the small scale business finances were from retained business profits.

### *2.5. Research Gaps*

Mungiru, J. W., & Njeru, A. (2015) did a research on the effects of informal finance on the performance of small and medium enterprises in Kiambu County and used a sample size of 95 SMEs within the Kiambu town. The study focused on factors such as trade credit finance, self-help group finance, family and friends finance; and shylock finance as the main bases used by SMEs to finance their business operations. The results from the study indicated a mixed outcome where it was established that self-help group finance, family and friends finance; trade credit finance had a positive effect on the performance of small scale and medium businesses activities while shylock finance sources have a negative influence on the performance of SMEs. However, this study did not exhaust all types of self-help groups which include Roscas such as table banking and Chamas which this study intends to look at how these types of informal finance and how they affect performance of women owned business enterprises.

### 3. Research Methodology

Descriptive research design was used in this study. A target population of 1000 registered small and medium enterprises owned by women was used from which 90 respondents were chosen. Simple random sampling procedure was used because of the homogeneity of the businesses. A questionnaire was used to assemble primary information from the representative population. Regression analysis was undertaken with an aim of establishing the nature of the relationship between study variables as well as the strength of these relationships.

### 4. Research Findings and Discussion

#### 4.1. Correlation Analysis

Correlation analysis was undertaken to establish the association between the study variables. Pearson correlation was employed to indicate the strength of correlation. These associations were tests for significance at 95% confidence level. The findings were as shown in table 4.9 below.

		Rotating Savings and Credit	Trade Credit Financing	Shylock Financing	Friends and Family	Financial Performance
Rotating Savings and Credit	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	67				
Trade Credit Financing	Pearson Correlation	.805**	1			
	Sig. (2-tailed)	.000				
	N	67	67			
Shylock Financing	Pearson Correlation	-.121	-.127	1		
	Sig. (2-tailed)	.331	.304			
	N	67	67	67		
Friends and Family	Pearson Correlation	-.052	-.187	-.077	1	
	Sig. (2-tailed)	.678	.131	.535		
	N	67	67	67	67	
Financial Performance	Pearson Correlation	.843**	.917**	-.140	-.175	1
	Sig. (2-tailed)	.000	.000	.258	.158	
	N	67	67	67	67	67

Table 1: Correlation Results

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

Correlation analysis indicated that, rotating savings and credit associations have a correlation with trade credit financing ( $r=0.805$ ). The association was very strong and positive. In addition, the association was significant at 95% confidence level ( $p$  value = 0.00). Financial performance had a very strong positive correlation with rotating savings ( $r = 0.843$ ). The correlation was significant at 95% confidence level ( $p$  value =  $0.00 < 0.05$ ). Further, very strong and positive correlation was established between financial performance and trade credit associations ( $r = 0.917$ ). The correlation was also significant at 95% confidence level ( $p$  value =  $0.00 < 0.05$ ). The study indicated that financial performance had a negative correlation with shylock financing ( $r = -0.140$ ). Financial performance also had a negative correlation with borrowing from friends and family ( $r = -0.175$ ).

#### 4.2. Regression Analysis

This study sought to analyze the effect of informal financing structure on financial performance of women owned enterprises in Kenya. The dependent variable was financial performance measured by profitability. The independent variables were; Rotating savings and credit associations, Trade credit financing, Shylock financing and borrowing from friends and family. The data was normalized using natural log and regressed based on the regression model defined in the methodology.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.935 <sup>a</sup>	.874	.866	.20108

Table 2: Model Summary

a. Predictors: (Constant), Borrowing From Friends and Family Members, Rotating Savings and Credit Associations, Shylock Financing, Trade Credit Financing

Model summary in regression analysis points out to the results of goodness fit. R squared is the coefficient of determination. In this study, the coefficient of determination was 0.874. This indicates that 87.4% of variation in financial performance is explained by independent variables. A proportion of 12.6% of variation in financial performance is explained by other variables not included in this study.

	Model	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	17.465	4	4.366	107.980	.000 <sup>b</sup>
	Residual	2.507	62	.040		
	Total	19.972	66			

Table 3: Analysis of Variance (ANOVA)

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Borrowing from Friends and Family Members, Rotating Savings and Credit Associations, Shylock Financing, Trade Credit Financing

Analysis of variance describes the significance of the overall model. From the results, the F statistic was 107.98. *P* value was 0.00 smaller than the critical *p* value 0.05. Given that this model was significant at 95% confidence level, it can be used to predict financial performance based on informal financing structure.

	Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.002	.624		.003	.998
	Rotating Savings and Credit Associations	.356	.089	.307	3.990	.000
	Trade Credit Financing	.621	.074	.661	8.436	.000
	Shylock Financing	-.005	.010	-.022	-.479	.633
	Borrowing From Friends and Family Members	-.005	.006	-.037	-.794	.430

Table 4: Regression Coefficients

a. Dependent Variable: Financial Performance

Constant for the regression model in this study had a coefficient of 0.002. However, the constant was not significant at 95% confidence level. Rotating Savings and Credit Associations had a coefficient of 0.356 indicating a positive relationship with financial performance. The relationship was significant at 95% confidence level ( $t = 3.990$ ;  $P$  value = 0.000).

Trade Credit Financing also indicated positive relationship with financial performance with a coefficient of 0.621. The relationship was significant at 95% confidence level. This implies that, a single unit increment in trade credit financing will cause 0.621 unit change in financial performance.

Negative relationship was found between shylock financing and financial performance as well as borrowing from family and friends and financial performance. As shown in table 4.16, both shylock financing and borrowing from family and friends and financial performance had a coefficient of -0.005. The relationship was not significant at 95% confidence level.

#### 4.3. Fitting the Regression Model

The regression model for this study was

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where  $Y$  = Financing on Financial Performance of Women Owned Enterprises in Kenya

$\beta_0$  = Constant

$X_1$  = Rotating Savings and Credit Associations

$X_2$  = Trade Credit Financing

$X_3$  = Shylock Financing

$X_4$  = Borrowing from Friends and Family Members

$\beta_1, \beta_2, \beta_3$  and  $\beta_4$  = Regression Coefficients

$\varepsilon$  = Error term

Based on the variables, the fitted model became.

$$Y = 0.002 + 0.356 X_1 + 0.621 X_2 - 0.005 X_3 - 0.005 X_4 + \varepsilon$$

#### 4.4. Discussion

Financing of business enterprises is a common practice not only on small ventures but even big companies. The difference is visible on the methods of raising capital. While big organization relies on bank loans and shares, small enterprises rely on bank loans and informal financing as the methods of raising capital. Given the unease access of bank loans due to interest rate capping, many small enterprises are turning into informal financing methods like rotating savings and credit associations, trade credit financing, shylock financing and borrowing from friends and family members. These forms of financing have different interest rates depending on the association, vendor and the shylock visited.

The available data has indicated that, in terms of interest rates, borrowing from family and friends has the lowest interest as it mostly attracts zero percent interest rates. On the negative side however, not many people seek this type of financing and achieve it as the advancers fear failing to be paid due to the nature of relationship between the borrower and the person lending the money. Inferential statistics have found that, there is no any significant relationship between

borrowing from friends and family and financial performance. Hypothesis testing too failed to reject the null hypothesis for borrowing from family and friends.

In every woman owned enterprise, rotating savings and credit associations financing has been ought to finance their business. Rotating savings and credit associations advance loans to members at a favourable rate compared to bank loans. In addition, they give favorable repayment period. While there is a limit to what amount one can borrow, statistic indicate that this type of financing has lifted women enterprises to some extent. The findings of this study have affirmed that rotating savings and credit associations has a significantly positive effect on financial performance. Hypothesis testing too confirmed that this type of informal financing was a significant predictor hence the rejection of the null hypothesis that like rotating savings and credit associations does not have any effect on financial performance.

In terms of amount of money borrowed, trade credits emerged to the only informal financing that business owners can utilise. This is linked with its nature and flexibility that; the vendor gives some time for selling before payment. This flexibility gives the buyers an opportunity to cater for the fast moving goods. In addition, the higher the trust garnered through timely payment, the higher the limit grows. In terms of interest rates, it was found that trade credits attract low interest rates just like rotating savings and credit association. Inferential statistics undertaken in this study established that trade credits have a positive effect on financial performance. This finding agrees with Muturi and Wanyoike (2018) who established a positive but moderate relationship between Trade credit financing, interpersonal borrowing and performance of women-owned SMEs.

Shylock financing has been in existence for quite some time though not well document in law in Kenya. It is the quickest financing option provided the borrow has a collateral. The dark side of this method is the high interest rates that stretch up to 60% as the terms are on daily basis calculations. The method is suitable for urgent intention that require huge sums with a guarantee to repay on shorter period. The findings of this study indicated that, not many entrepreneurs go for this financing. Secondly, the findings did not find any significant relationship with financial performance. The regression analysis found a negative coefficient for Shylock financing while ANOVA test of hypothesis failed to reject the null hypothesis that Shylock financing does not have any effect on financial performance.

The findings of this study concur with Mungiru and Njeru (2015) that self-help group finance, family and friends finance; trade credit finance had a positive effect on the performance of small scale and medium businesses activities while shylock finance sources have a negative influence on the performance of SMEs.

## 5. Summary, Conclusion and Recommendations

### 5.1. Summary

Rotating savings and credit associations was one of the favorable financing to enterprises. On average, the amount borrowed range from Ksh. 73238.80 to Ksh. 83074.60. The financing attracts lower interest rates of less than 5%. The findings of this study established that financing through Rotating savings and credit associations has a positive effect on financial performance.

Majority of enterprises rely heavily on this form of informal financing. This is inferred from huge sums borrowed by entrepreneurs. The financing method was found flexible and favorable in terms of repayment period and interest rates. This study found out that trade credits have a significant positive effect on financial performance.

The findings indicated that, not all entrepreneurs seek this type of informal financing. In fact, the average amounts borrowed ranged between Kshs. 22,729.20 and Kshs. 39,144.10. Respondents held that, this type of financing is favorable for financing urgent matters which sometimes can lead to huge loses. Regression analysis found a negative coefficient of Shylock financing. However, the method was found not significant to determine financial performance.

Borrowing from family and friends was found to have 0% interest rates. However, this informal financing could only raise small amounts which sometimes might appear inadequate financing an enterprise. Further, the findings indicated that not all enterprises have borrowings from family and friends unlike trade credits and Rosca. The inferential statistics did not find any relationship between borrowing from family and friends with financial performance.

### 5.2. Conclusion

The correlations and regression analysis found that, Rosca and trade credits have a significant positive effect on financial performance, while Shylock financing and borrowing from friends and family have no significant effect on financial performance.

Rosca is available to members at reasonable interest rates, indicating that, women entrepreneurs can utilise this chance to finance their businesses. Given the findings of this study, Rosca will lead to increased financial performance. Therefore, a conclusion was reached that Rosca is a significant contributor to financial performance.

Trade Credits in a big way affect financial performance positively. As found in the statistics, trade credits give flexible financing and is the mostly utilized informal financing. The findings further affirm that, increase in trade credits leads to increase in financial performance. Thus, trade credit is a significant contributor to financial performance.

Shylock and borrowing from family and friends do not have any significant effect on financial performance. This implies that, any more funding from these informal methods is likely to lead to negative or no returns based on the amount borrowed and the interest rates accorded. Therefore, this study concluded that shylock financing and borrowing from family and friends have no significant effect on financial performance.

In view of Rosca and trade credits, this study adds to the body knowledge that informal financing has an effect on financial performance of women owned enterprises in Kenya.

### 5.3. Recommendations

This study found out that Rosca and trade credits have positive effect on financial performance. In addition, they have favorable terms that can boost businesses for better performance. Therefore, this study recommends entrepreneurs to utilize these informal methods if they opt informal financing way.

Shylock financing was found unfavorable in financing business enterprise. This is due to huge interest rates, provision of collateral and the non-impact on financial performance. Therefore, this study recommends that small enterprises should opt for this financing if the matter at hand is urgent and likely to cause losses if not funded.

Borrowing from friends and family though with zero interest rates, it results to smaller amounts that are inadequate to finance business enterprise. In addition, borrowing from family and friends is not a guarantee that the loan will be given in full and in time. This study recommends that this option could be exercised if Rosca and trade credit fail.

### 5.4. Suggestion for Further study

This study majorly looked at Rosca, trade credits, Shylock financing and borrowing from friend and family members. Currently mobile loans have become common and enticing to business owners. Therefore, a further study can include mobile loans as a way of financing and its effect on profitability of a firm.

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