BANKING SERVICES AND THE STATUS OF SMALL AND MEDIUM SCALE ENTERPRISES IN RUIRU TOWN;

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By:

Robert Gitau Muigai

MBA/20381/72/DF

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DECLARATION A

"This thesis is my original work and has not been presented for a Degree or any other academic award in any University or Institution of Learning".

ROBERT GITAU MUIGAI

Name and Signature of Candidate

22/09/2010.

Date

DECLARATION B

"I confirm that the work reported in this thesis was carried out by the candidate under my supervision".

Name and Signature of Supervisor

MICHAEL RUTEGANDA

Date 22/09/10

APPROVAL SHEET

This thesis entitled" Banking Services and the status of Small and Medium Scale Enterprises in Ruiru Town" prepared and submitted by Robert Gitau Muigai in partial fulfillment of the requirements for the degree of Masters of Business Administration has been examined and approved by the panel on oral examination with a grade of PASSED.

Name and Sig. of Chairman

MICHAEL MUTEGANDA

Name and Sig of Supervisor

Malinga Ramadhan

Name and Sig. of Panelist

Olutayo K. Osunsan

Name and Sig. of Panelist

Otindo Irene Kuusa

Name and Sig. of Panelist

Date of Comprehensive Examination: 20/09/2010

Grade:

Name and Sig of Director, SPGSR

Name and Sig of DVC, SPGSR

DEDICATION

The researcher dedicates this work to his dear wife and two daughters who have offered him indescribable moral support in his pursuit of this dream.

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ABSTRACT

Formal commercial banks have been recommended as the major source of external financing for the Small and Medium scale Enterprises (SMEs) sector. This is because the informal financial institutions are known to be dogged with both inadequate regulatory framework and problems of financial proficiency therefore making them unreliable in propagating sustainable development of this sector.

The study examined the level of interaction between banks and SMEs and the specific gains realized by SMEs sector as a result of this interaction. The study also assessed the bottlenecks experienced by both banks and SMEs in the process of relating with one another. Finally, the study established the different strategies adopted by banks in deepening their service delivery to the SMEs sector. This was accomplished by gathering the relevant information through questionnaires from the proprietors of SMEs operating in Ruiru town and staff of the banks with outlets in the area.

The study found that though banks offered to SMEs a wide variety of services, SMEs have not been able to fully utilize these facilities because of the procedural and cost burdens involved. Banks also perceived lending to SMEs as a risky venture and therefore adopt a more cautious approach or charged a risk premium which further kept the SMEs at bay. Nonetheless, it was evident from the study that despite the existing limitations, banks have played a pivotal role in promoting the welfare of SMEs.

In the light of the findings of the study, the researcher made various recommendations meant to address the critical financing problem in the SMEs sector which included broad-based government policy interventions, enhanced capacity building through training of proprietors and managers as well as rationalized application of bank's lending policies.

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CHAPTER ONE

THE PROBLEM AND ITS SCOPE

Background of the Study

SMEs play a key role in both the transitional and developing countries. According to Fundes (2002), these firms typically account for over 90% of all business firms and constitute a major source of employment besides contributing immensely to the gross domestic product of their respective countries. This has necessitated integration of the SME development strategy into the broader national development strategy and/or poverty reduction strategy.

The challenge of unemployment has compelled governments to adopt policies geared towards promoting the SME sector with a hope to create jobs for the population. According to the Business Guide to Development Actors (2004), SMEs sector generates the lion's share of new jobs in the developing countries which was rated at between 70%-80%.

Fostering development of SME sector has nonetheless not gone without a fair share of challenges. According to the African Economic Outlook (2004 – 2005), the challenges experienced by SMEs sector are massive that should be "mid-wifed" if the sector is to realize sustained development. Many of these limitations range from lack of adequate regulatory framework, inadequate capacity building through provision of vocational training to proprietors, overreliance to unpredictable weather conditions etc.

Among the numerous challenges faced by the SME sector, access to finance has been identified as the topmost obstacle to their expansion. Robert (2006) indicated that while SMEs are critical to a country's long term development strategy, sustainable access to finance and inclusive business design are fundamental in ensuring long term and equitable poverty reduction and business profitability.

However, according to White (2002), banking institutions have continuously turned their backs to the SMEs sector's pleas for financing and instead have preferred to do business with large corporate organizations which 'have enough collateral" to cover their lending. Though banking institutions have been identified as the major source of SMEs financing, majority of the mainstream institutions perceive the SMEs sector as lacking in sustainable development and therefore adopt a cautious approach in dealing with the SMEs sector. As a result, the sector has largely relied on informal and otherwise unreliable sources of financing which has compromised their profit potential.

In the Kenya's context, the importance of improving financial access to the SMEs was identified as a key development strategy right from independence. Nonetheless, according to Kimuyu (1999), formal banks that were inherited from the colonialists and largely expected to boost credit to the SMEs sector were found to be concentrating their services to the big corporate organizations. They cited drawbacks such as low effective or dispersed demand, high transaction and information costs, high levels of unmitigated risks, lack of usable collateral, weak contract enforcement, inadequate regulatory frameworks as well as dependence on seasonal agricultural activities as preventing them from rolling out their services to SMEs.

Chao-Berrof (2000) wrote that scarcity of financial services led to emergence of the microfinance institutions (MFIs) which came to bridge the created financial gap. Though the MFIs initially targeted the rural based agricultural sector, they later expanded their services to other sectors albeit with minimal impact (Kimuyu, 1999). Their low impact was attributed to factors like lack of adequate legal and operating framework which made it difficult to enforce contracts as well as dispense their services resolutely.

As a remedy, the government stepped in to offer subsidized financial intervention through state-owned development corporations. In spite of these efforts, the demand for financial access by the SMEs sector hasn't been adequately addressed and remained (s) a big impediment to growth of the sector in Kenya.

Statement of the Problem

According to the Republic of Kenya Economic Review (2007), the banking sector has continued to expand at unprecedented rate with majority of banking institutions posting enviable pre-tax profits every year. Their credit and assets portfolio have also been rising year after year. In that respect, Kenya's financial sector is regarded as one of the most robust in the Sub-Saharan Africa in terms of stability, regulation and outreach.

However, on the budget speech of 2006/2007, Kimunya noted that in spite of an impressive economic growth of a record 8%, poverty still exists and the level of unemployment in the country was alarming. The trend was attributed to over reliance on formal employment sector at the expense of self employment. The SMEs sector was termed as an invaluable avenue for making the youth and women self reliant instead of putting their hope to the ever dimming formal employment sector. To that end, the government established the youth enterprise fund (YEF) and women enterprise fund (WEF) through which both young and women entrepreneurs would be provided with loans to establish viable SMEs. The formal banking sector was also challenged to support the sector through financing and extending other value-adding services which would contribute to improvement and expansion of this "backbone" sector.

Despite all these efforts, the Kenya Economic Review report (2009) indicated that the SME sector which was largely targeted to offer alternative source of livelihood for many families and contribute immensely to the country's GDP has not been able to unlock its full potential principally for lack of adequate financing from established banking institutions.

This undesirable and worsening situation has fronted a challenge to researchers and economic development activists. It is against this background that the researcher has set out to establish the impact of banking institutions on development of SMEs.

Purpose of the Study

While a lot of studies have been advanced towards understanding of the demand side of SME lending, little research exists on the supply side of bank financing to SMEs across countries.

The study therefore advances an understanding of the supply side of bank financing to the SMEs by establishing their level of interaction, the resultant benefits accrued by SMEs and the bottlenecks experienced by both entities in Ruiru town

Research Objectives

1. To identify different forms of SMEs ownership in the area.
2. To identify the different services offered to SMEs by the banks.
3. To determine how SMEs have utilized the services offered by banks.
4. To identify the gains realized by SMEs from existence of the banks.
5. To identify the challenges faced by the banks in offering their services to the SMEs
6. To identify the limitations experienced by SMEs while dealing with banks.
7. To identify the strategies adopted by the banks in deepening their service delivery to SMEs.

Research questions

1. What are the different forms of SMEs ownership in the area?
2. What are the different services offered to SMEs by the banks?
3. How have the SME sector utilized the services offered by the banks?
4. What benefits have been achieved by SMEs from existence of the banks?
5. What challenges do the banks face in offering their services to SMEs?
6. What limitations do SMEs face while dealing with the banks in the area?
7. What strategies have been adopted by banks in deepening their services to the SME sector?

Scope

The study was conducted within Ruiru town. The area was selected because the 4 main stream banking institutions in the country have established outlets within the town namely: Equity bank, Kenya Commercial Bank (KCB), Family bank and National bank. Located 25 kilometers north of Nairobi and with a semi-rural setting, the town has a huge business growth potential mainly because of its catchment and the available infrastructural facilities.

The study sought to establish the prevalent mode of SMEs ownership; the major services offered by the BIs in the area and determine the uptake level of these services among the SMEs. The study identified whether the SMEs have benefited from utilizing these services and find out the challenges they experience while dealing with the banks. The study identified the limitations faced by the banks in the course of offering their services to SMEs and explored the strategies adopted by banks in deepening their service delivery to SMEs in the area. Finally, the study considered if the status of the SMEs sector has improved as a result of interacting with the banking institutions in the area.

Significance of the study

The study is significant in the following aspects:

1. The proprietors of the SMEs will become aware of the different types of services rendered by the BIs and therefore be in a better position to make informed entrepreneurial decisions.
2. The SMEs proprietors will also appreciate the challenges that accompany doing business within the sector which will assist them in collective lobbying through stakeholder's and advocacy groups.
3. The banks will also be able to formulate suitable policies that will address the real needs of the SMEs as well as improve on the existing ones by designing favorable strategies to deepen their service delivery to the SME sector.
4. The government and other policy formulators will appreciate the need to support the banks and SMEs by providing an enabling environment to assist the upcoming entrepreneurs.

Operational Definition of Key Terms

Below is the definition of key terms as used in the study:

Banks – Institutions incorporated under the Banking Act (Cap 488) of the laws of Kenya

Banking Services – Services offered by banks e.g. Savings, Loans, Business advisory, and Overdraft.

Gross Domestic Product – The aggregate dollar total revenue and expenditure in a country's economy.

Jua Kali – The term used to refer to the informal sector in Kenya

Microfinance Institutions – Institutions offering lending services to clients other than banking institutions.

Small and Medium Scale Enterprises (SMEs) – Business entities with employees ranging from five to ninety nine and an average annual turnover not exceeding Kenya shillings five million.

Status – The position or condition of reference of the Small and Medium Scale Enterprises

CHAPTER TWO

REVIEW OF RELATED LITERATURE

Introduction

The researcher commences the literature review by exploring the concepts, ideas and opinions on topical issues related the study as presented by various authors.

The second section of the review depicts the theoretical perspective on the variables of the study as presented by other researchers.

We will conclude our review by discussing empirical observations by various experts on the concept of SMEs financing.

CONCEPTS, IDEAS AND OPINIONS FROM AUTHORS/EXPERTS

Towards defining the SMEs

The terms informal, micro, cottage, small, and medium enterprises are commonly used in SMEs literature internationally. In Kenya, another term *Jua Kali* has been added to the repertoire.

Informal enterprises have been defined by Nilgun (2002) as those enterprises whose owners do not usually conform with the regulations governing normal business activities like business registration, tax payment, observance of wage regulations and contribution to workers' social security funds.

Meyer (2005) however, cautioned against the use of informal or formal nature of an enterprise to classify it. The concern was that countries varied with regard to laws governing businesses. Instead, they have opted for classification depending on the number of workers which a firm engages on a full-time basis. Accordingly, firms with 1 - 4 workers were grouped as household enterprises. Those with 5 -

99 workers are classified as small and medium enterprises (SMEs) and those which employ 100 and more workers are designated as large enterprises (LEs).

The classification of enterprises in The Republic of Korea, though based on the number of workers employed by enterprises, is quite different from that used by Kim et al (2004) who grouped the firms in Korea as small, medium and large enterprises as follows: Small enterprises are those which employ 5 - 19 workers, medium enterprises employ 20 -199, and large enterprises are those which have 200 or more employees. In Japan, SMEs are firms with less than 300 workers.

Nigeria uses turnover to classify enterprises. The Central Bank of Nigeria categories firms with turnover of up to 500,000 Naira (US$454.34) as small-scale enterprises (Ekpenyong and Nyong, 1992).

Classification of enterprises is primarily by the number of employees engaged by firms in Kenya. Those firms which engage less than five employees are referred to as microenterprises. Those which employ 5-49 workers and 50-99 workers are respectively classified as small scale enterprises and medium-scale enterprises. The firms with 100 or more workers are categorized as large-scale enterprises.

From the literature, it can be deduced that there is some similarity with regard to enterprise classification across a number of nations. Firms with less than five workers are variously referred to as household or micro enterprises. Most of the nations categorize firms with employees in the range of 5 - 49 as small-scale enterprises. The medium-scale enterprises are those which have 50 - 99 workers. Firms with 100 or more workers are grouped as large-scale enterprises. It is however imperative to note that the nations with large economies, like Japan and South Korea, consider firms to be large-scale when their employment capacities are much higher.

Status of SMEs sector in Kenya

Meyer (2005) indicated that through a report by the International Labor Organization on the unemployment problem in Kenya and the need to focus on the emerging informal sector as a partial solution to the problem, the attention of policy makers on the small size enterprises in the country started to crystallize.

The government of Kenya has since prepared a number of sessional papers and development plans which focuses on the development of micro and SMEs in Kenya (Republic of Kenya Economic review report, 2007). In these documents, the government stressed the critical role of small enterprises in the national economy and outlined the policy interventions needed to enhance their growth. The first sessional paper of 1986 on Economic Management for Renewed Growth singled out the small enterprise sector and rural economy as future generators of employment. Six years later, in 1992, the Government prepared a paper entitled "A Strategy for Small Enterprise Development in Kenya: Toward the Year 2000," in which it documented the major impediments to small enterprise development and enunciated policies for improving the performance of the sector. Critical barriers identified were: difficulty in raising capital, limited managerial skills, regulatory constraints, low marketing skills, limited extension services and difficulty in getting access to technology. The second sessional Paper of 1999 on Small Enterprise and "Jua Kali" Development in Kenya was published in 1999. The government outlined the contributions of the small enterprise sector to the national economy, the key ones being: Employment creation, enhancing the participation of indigenous Kenyans in the economy, Promotion of local savings and investments, promoting the development of entrepreneurship and managerial skills among local Kenyans and engendering the acquisition of skills among workers.

Kimuyu (1999), in a paper presented during a workshop in Nairobi, Kenya, provided some revealing statistics about the SME sector. The number of firms in the sector stood at 1.8 million in 2006. Of the enterprises, 64.0 percent were in goods trade, 23.0 percent in services and 13.0 percent in manufacturing. According to the paper, the distribution of the firms by location was as follows:

Nairobi and Mombasa	1,290,430
Other towns	213,406
Rural Areas	296,164

According to the Central Bureau of Statistics report (2009), the SMEs themselves have continued to increase in number to a level where in 2009 it was estimated that there were about 2.5 million SMEs in Kenya offering employment to over 15 million people. This quantitative growth of the sector has engendered sustained research, resulting in a wealth of literature, particularly with regard to size, employment generation capacity, financial support and business regulations.

Challenges facing the SMEs Sector

According to Nadvi (1995), SMEs are key to economic development due to their proven role in wealth and job creation. However they face huge challenges in developing innovative and world class products, processes or services to enhance their competitiveness as compared to larger companies. These include but are not restricted to lack of finance, difficulties in acquiring and exploiting appropriate technology, constrained managerial capabilities, low productivity and regulatory issues to name but a few.

OECD (2003) observed that the challenges faced by SMEs sector are multi-dimensional. In the advent of globalization, SMEs are required to add more value to their products to stay ahead and compete with lower cost rivals. Consumer demand is changing rapidly as incomes rise and choices increase then imported products become easily available in domestic markets. Technological advances create new products and transform almost every facet of business from production to marketing, sourcing and logistics. New rules introduced through the multilateral trade system and foreign buyers require SMEs to comply with higher technical, environmental and labor standards in domestic and export markets. Multinational enterprises seeking out new markets and investments offer capable SMEs the opportunity to insert themselves into global value chains through subcontracting linkages, while those that are unable to do so increasingly face the danger of losing their existing markets. Competition within the developing world for export markets, foreign investment and resources is also intensifying.

According to Dengate (2003), many SMEs owners or managers lack managerial training and experience. The typical owner or managers of small businesses develop their own approach to management through a process of trial and error. As a result, their management style is likely to be more intuitive than analytical, more concerned with day-to-day operations than long-term issues, and more opportunistic than strategic in its concept. A consequence of poor managerial ability is that SME owners are ill prepared to face changes in the business environment and to plan appropriate changes in technology.

World Bank's Doing Business report (2007) noted that countries with poor business environments i.e. costly regulations, heavy bureaucracy, poor credit and banking systems tend to have large "informal" sectors. These are economic activities outside the formal regulatory environment. In Bolivia for example, out of a population of eight million, only one million people had formal employment in the private sector. In Burkina Faso, out of a population of twelve million people, only fifty thousands were employed in the formal sector. For many SMEs, the report observed that the decision to remain informal was deliberate, basically because the costs and procedural burden of joining the formal sector outweigh the benefits.

Dani (2003) opined that one key challenge that continues to face the SME sector is deficiency of appropriate legal and administrative mechanisms that encourage informal businesses to shift to the formal sector so that they can interface productively with other stakeholders e.g. bankers, creditors, investors, public services and international markets. He therefore encouraged the policy makers to put in place friendly administrative and legal framework that will necessitate registration of businesses and ensure compliance with regulations for ease of operations.

According to Morriset (2000), access to financial services has been identified as a major problem experienced by many SMEs in doing business in Kenya. Commercial banks are reluctant to lend to SMEs because they lack adequate or credible credit history and any usable collateral. He wrote that further explanation for locking out the SMEs in financial services by commercial banks is high transaction cost and perceived high risks. Commercial banks also regard the SMEs as an economic burden in that they cannot save but only are consumers of credit. Therefore, the commercial banks focus on credit products to the big institutions.

According to Schneider (2008), there are various other financial challenges that face small enterprises. They include the high cost of credit, high bank charges and fees. The scenario witnessed in Kenya particularly during the climaxing period of the year 2008 testifies the need for credit among the common and low earning entrepreneurs. Numerous money lenders in the name of Pyramid schemes came up, promising hope among the 'little investors,' promising that they can make it to the financial freedom through soft borrowing. The rationale behind turning to these schemes among a good number of entrepreneurs is mainly to seek alternatives and soft credit with low interest rates while making profits. Financial constraint therefore remains a major challenge facing SMEs in Kenya.

Promoting SMEs sector

The contribution of SME sector in any economy cannot be overemphasized. While addressing the delegation from the World Bank during the Kenya Private Sector Alliance's (KEPSA) SME solution Centre (SSC) convention in May 2008, the chairman said "the Small and Medium-sized enterprise sector play a critical role in the national economy both as a means of alternative employment through job creation as well as immensely boosting the GDP". He therefore challenged the governments of the developing countries and stakeholders to identify long term strategies for promoting the sector which he regarded as "the backbone" of the economy. Among the key recommendations, he emphasized on the need to ensure accessible and affordable financing of SMEs activities as well as availability of ready markets for the products and services by SMEs.

According to the Meyer (2005), governments have a responsibility to establish appropriate frameworks in which development can take place. It is incumbent on all governments to create a conducive environment for SME development by putting equal emphasis on their micro and macro policies. This should be achieved through facilitating continuous policy dialogue with the private sector for policy, programme and strategy design and development and designing low-cost legal and administrative mechanisms that encourage informal businesses to shift to the formal sector so that they can interface productively with creditors, investors, public services and international markets.

Wignaraja (2003) opined that with the onset of globalization and liberalization, the gap between developing countries and the developed world is widening which need not be the case. He recommended that African governments must build a strong, SME sector to bridge this gap. To facilitate enterprise creation, business registration should be simplified and decentralized, thus eliminating the link between high administrative burdens and corruption. In particular, African governments should establish a dedicated Ministry responsible for micro, small and medium sized enterprises (MSMEs) where they have not yet been established cut the cost of business registration, licenses and other approvals by establishing a one stop-shop for SMEs, simplify the tax regime for SMEs, create an SME development fund for capacity-building and create incentives for the banking community to do business with SMEs including requiring disclosure of bank loan portfolios, applying lower tax rates to profits arising from their SME portfolios, and providing credit and investment guarantees.

Nilgun (2002) noted that the business community, including SME associations, must act as advocacy groups for the appropriate SME policies by providing services that will enhance the competitiveness of their members. They are better able than the government to provide these services since they are closer to their clients and know their needs. In particular, they can promote clustering among small enterprises and linkages between large and small enterprises. He observed that high tech clusters and linkages to global supply chains can improve export competitiveness. He advised that the business community should also cooperate with central, regional and local governments in rendering effective support to SMEs, particularly in the fields of upgrading managerial capacity, product quality improvement, and exports. This can be achieved by participating in policy dialogue with national government to review existing policies and to propose new ones as the case may be, networking with other business associations worldwide, providing business services to their members especially women entrepreneurs as well as entering into partnerships to reduce the perceived risks and transactions costs of banks by assisting them in the pre-credit appraisal of SMEs seeking loans and monitor their repayment.

Banking Sector in Kenya

Outreach of the Banks in Kenya

Kenya's banking system is fairly developed and diversified. At the apex of the sector is the Central Bank of Kenya, which is the central authority in the country. This institution was established by the Act of Parliament in 1966 with a mandate to supervise the operation of commercial banks to ensure that they carry out their business prudently. Central Bank of Kenya (CBK) accomplishes this objective through the Banking act (Cap 488) and prudential guidelines which are promulgated from time to time.

According to CBK special report (2010), by the end of the year 2009, we have forty five licensed commercial banks with a total liquid asset base of Kshs 1.31 trillion and cumulative profit before tax of Kshs 36.95 billion.

Zeller, (Undated) posits that though governments traditionally used subsidized credit programs to promote agricultural growth, this approach has failed to bolster the incomes and alleviate poverty in rural areas. He opined that since the mid 1980s, there has been a paradigm shift in financial policies (including rural financing) from directed, subsidized credit to sustainable financial institutions and systems. This new shift emanated from the recognition that technological and institutional innovations are available that can bridge the gap between demand and supply of financial services so as to reduce the costs and risk of financial intermediation.

According to Murgatrod et al (2004), financial intervention in Kenya has been through 3 channels i.e. formal, semi-formal and informal institutions with the level of formality defined by the degree of formal regulation and supervision. The formal category includes banks and financial institutions licensed under the banking act, building societies and Kenya Post office savings Bank. The semi-formal category includes Savings and Credit Cooperative Societies (SACCOs), MFIs, Development Financial Institutions (DFIs) e.g. Agricultural Finance Corporation (AFC), Industrial Development Bank (IDB), Industrial and Commercial Development Corporation (ICDC) and Kenya Tourism Development Corporation (KTDC) and Kenya Industrial Estates (KIE). The Accumulating and Rotating and Credit associations (ASCAS, and ROSCAs), Shopkeepers and moneylenders dominate the informal category.

In 2007, government of Kenya published "Kenya's Vision 2030" as a long term development plan for the country which puts provision of financial services at the centre of the planned economic growth trajectory to the year 2030. One of the main objectives articulated for the financial sector was to "improve access to financial services and products for a much larger number of Kenyan households". This was to be achieved by having the banks lower the prices they need to charge to retain reasonable profitability, reducing interest rate spreads as well as use of greater innovation to offer more products that are suitable for smaller borrowers and savers.

According to KIPPRA Report (2008), financial exclusion falls disproportionately on rural areas. He observed that while just over one out of five in urban areas is financially excluded, one in three of those based in rural areas is unable to access financial services. He attributed this to the tendency by financial institutions to favor operating outlets within the already established areas served with adequate infrastructural and communication networks.

According to the Financial Access Survey (2009), 32.8% of Kenyans have no access to financial services and are therefore financially excluded. The report further notes that though this was an improvement from 38% reported in 2006, the Kenya's formal banking sector is far from achieving its full potential covering 22% and informal Financial Institutions taking the lion's share of 45%.

However, the positive changes seen in financial inclusion reflect the continuation of a major expansion in the provision of financial services in Kenya. Particularly, there has been a significant expansion in outreach by banks over the last two and a half years. In his keynote addresses dated Nov 20th 2009, the governor of CBK confirmed this when he said "One of the major successes in the banking sector has been the expansion of branch network of the key banking institutions in Kenya". He nonetheless indicated that opportunities to increase access to financial services to the majority of the population are not yet exhausted if the objective of monetizing the economy is to be realized.

The growth in the commercial banking segment continues to be led by Equity Bank that has the largest expansion in client base of any large bank, increasing by 64% over the year 2009 to finish the year with over 4.5 million accounts representing an estimated 47% of the bank accounts market by the year end. A number of the other larger network banks have also continued expansion over the year, although not at a pace which matches Equity's. These are Barclays, Standard Chartered, Co-operative, National, and Family among others (Central Bank Special report, 2009).

Challenges faced by the Banks in Kenya

Acemoglu (2003) indicated that one of the biggest impediments of the banking sector is the problem of non-performing loans. In his opinion, this has been brought about by the liberalization of lending and lack of stringent supervisory aspect by the central bank. With the onset of cut-throat competition between banks, every entity wants to survive and banks have sometimes lent their money too generously and overlooked the control that goes with it. Furthermore, there is an inadequate credit management policy by many upcoming banks which wants to compete with the dominant institutions. The result has been unhealthy administration of loan facilities and therefore a high number of non-performing loans (NPLs).

Clive (2006) observed that faced with the problem of NPLs, banks are fear to continue giving loans to clients without sufficient collateral. Accordingly, what the banks call collateral is sometimes not within the reach of the small scale sector. Sometimes, big commercial banks exclusively deal with real asset security which must be within five kilometer radius of the city center. This is sometimes ridiculous and out of the reach of the common businesspeople. The result is to exclude this sector from financial access bracket.

According to Arora (2002), although banks are in a business of lending money and making profit, sometimes they are not able to adequately evaluate the creditworthiness of borrowers. First-time borrowers who have not yet established their relationship with banks are a risk considering that the concept of credit referencing is absent in Kenya. Effectively, many would-be borrowers are locked out of financial bracket and end up turning to informal lenders who many a times charge high premiums on the loaned funds.

THEORETICAL PERSPECTIVES

Conceptual Framework

According to Eckstein (2007), few debate the view that a vibrant SME sector can form the bedrock on which all economic activity is built, and that SMEs can be the mainstay of an economy, particularly in terms of employment. He opined that in many emerging markets the SME sector is one of the principal driving forces for economic growth and job creation. In his perspective, to ensure sustainable economic development, governments should promote growth of SMEs sector. The support should involve promoting the entrepreneurial skills of the population in order to make them self-reliant, providing suitable infrastructural, social, political, regulatory and environmental support. It's the role of the government to also lay down sound economic policies and strengthen the financial systems. Under these contextual conditions, the financial service providers including the banking institutions will be able to provide services which will comprise of financial intermediation, enterprise development and social intermediation among others. Consequently, the impact of the banks on SMEs sector development will be realized through creation of employment, poverty reduction, increased GDP level, improved social welfare and trade development. Below is the conceptual diagrammatical presentation;

Figure 1.1: Conceptual Framework

Source: Quarterly journal, Eckstein (2007)

RELATED STUDIES

SMEs Sector Financing

According to Dermiguc-Kunt (2005), the financing of SMEs has been a subject of great interest both to policy-makers and researchers because of their significance in private sectors around the world. More importantly, a number of studies using firm-level survey data have shown that SMEs not only perceive access to finance and the cost of credit to be greater obstacles than large firms, but these factors constrain SMEs more than large firms.

Given the importance placed upon the SMEs sector, it looks set to be exploited by all countries to maximize the economic well being of its citizens; in particular newly emerging economies have a large percentage of their businesses which may be classified as SMEs. Therefore, this leaves no doubt that the SME sector is set to be the focus of the government policy.

Brenneisen (2004) noted that despite the enormous opportunities presented to SMEs in Africa, they face many obstacles including corrupt governance structures, unfavorable macroeconomic environment, debilitating physical infrastructure, and administrative challenges. However, inadequate access to financing continues to be one of the most significant impediments to creation, survival, and growth of SMEs in Africa.

According to Graham (2004), Western academics and practitioners' literature relating to SMEs finance over the last several decades have also acknowledged the importance of and financing issues for SMEs for economic well being. They acknowledged that to sustain the competitive advantage of developed economies and to accelerate the growth amongst developing economies, access to capital for start-ups and growth orientated SMEs is pre-requisite and imperfections between the provider and the recipient limits the growth of SMEs and adversely impacts on an economy's competitiveness.

According to Mule et al (2002), sustainable growth of the developing economies is directly related to the rate of enterprise creation and development. This in turn depends on the ease with which SMEs can be started and financed, given their large contribution to the national economic development. One of the critical constraints facing SMEs has been widely acknowledged to be a lack of access to credit. Obtaining the medium- to long-term financing they need from commercial banks if they are to realize their business potential remains the major obstacle for SMEs. Without finance, SMEs cannot acquire new technologies, compete in the global market or establish linkages with larger firms.

In Uganda, Duursma (2006) observed that SMEs tend to rely on informal sources of funds such as family, friends, credit cards, supplier credit and customer advances. This is because commercial banks preferred selected customers such as Governments and large enterprises, thus crowding out SMEs. From commercial banks' point of view, lending to SMEs involves high transaction costs due to factors like inability to assess creditworthiness, poor financial information, unreliable accounting and unrealistic business plans. He nonetheless pointed out that though the obstacles to SME lending are universal, there is growing evidence that some commercial banks in developed countries have found innovative ways around these obstacles and are serving SMEs and making a profit.

According to Jayazeri (2008), SMEs themselves are growth-and development-oriented and therefore an enabling policy, legal and regulatory framework are necessary ingredients towards boosting their performance in developing economies. In addition, he challenged SMEs to make themselves attractive for bank lending because no professionally run bank will attempt to lend to any business which is not creditworthy or has no track record of being able to repay a loan. In his submission, it makes business sense for banks not to lend to start-ups and/or small-scale businesses, which have not accumulated a minimum amount of assets or demonstrated both business capability and creditworthiness. Nonetheless, banks, on the other hand, have to develop positive attitudes towards SMEs and find alternative, innovative ways of assessing risks. He advised that in small open economies where there are relatively few large firms, investment choices are limited and banks have to begin relying on small firms to grow with together.

According to a USAID report on Financing SMES (2009), the record of actually expanding access to finance has been mixed in all countries. This is partly because the financing of SMEs presents specific challenges for prospective financiers who must make special efforts to operate in this market segment. SMEs are perceived to have a much higher rate of failure than larger firms. Besides, they are typically more opaque than larger companies because they usually do not produce audited financial statements that yield credible financial information and have no obligation to make public disclosure. Moreover, unlike established public companies, which are expected to observe standards of corporate governance with clearly defined roles for shareholders, managers, and other stakeholders, SMEs tend to reflect the idiosyncrasies of their owners and their informal relationships with stakeholders. Finally, the risk of the principal/agent dilemma, which is inherent in all financing operations, is particularly acute with SMEs. In addition to these risks of SME lending, many financiers consider it to be more costly — and therefore less profitable — to lend to SMEs. Financiers often state that it takes about the same amount of time and resources to source, evaluate, approve, and monitor a loan to an SME as it does to a large company. However, because the loans are smaller, the ratio of costs to the loan amount is proportionately higher (while the revenue generated from the loan in interest and fee income is proportionally lower). In order to lend successfully to SMEs, financiers must learn how to reduce risks and share risks with the borrowers, and to reduce the costs relative to the size of the loans.

Though it is accepted that most small firms will never be able to raise all the funding they would like from banks and other institutions, Ulusay (2001) observed that the effort to resolve the problem of access to finance is not solely the responsibility of governments. SMEs need to take a better initiative than pointing it out as their number one obstacle. They need to mobilize joint advocacy and recommendations based on sound analyses through their membership organizations. Most significantly, SMEs must implement sound business practices and continuously invest in good internal management systems such as accounting, planning, financial, operations and human resource management.

CHAPTER THREE

METHODOLOGY

Research Design

The research was based on a descriptive case study design involving a cross sectional survey of different entities. The study focuses on banks as opposed to other financial institutions because studies have shown that banks are the main source of external finance for SMEs across countries.

Research Population

The population of the study consisted of:

1. Proprietors and managers of business firms with an employee capacity of between five to ninety nine and average annual turnover not exceeding Kenya shilling five million as these constituted the SMEs. There were one hundred fifty four firms in the area which met the criteria and therefore qualified for inclusion in the study.
2. Managers and staff of the four major banking institutions with outlets in Ruiru town. They are: KCB, Equity Bank, Family Bank and National Bank. All the four banks were included in the study.

Sample Size

The sample for the SMEs was generated from a list provided by the Ruiru Town Council which is the sole licensing authority for all businesses operating in the area. Out of the identified one hundred fifty four enterprises licensed to operate in the area as at 31st December 2009, ninety firms were selected to form the sample for the study because the researcher determined the sample as appropriate for the study.

All the four banks operating in the area formed the sample of the study.

Sampling Procedure

In selecting the sample, the researcher organized the list of the one hundred fifty four firms in alphabetical order and randomly selected the first seventy seven firms whose position was odd number on the list. The remaining firms were again reorganized alphabetically and the researcher selected every sixth firm on the newly developed list as the method gave every firm equal chance of participating in the study.

Purposive sampling was employed in selecting the bank staff to participate in the study. This was based on their seniority, level of interaction with clients and knowledge of the subject of study. Five banking staff were selected in each of the banks as the number was deemed appropriate for the study.

Research Instruments

The researcher utilized both researcher-devised questionnaires to obtain data from the respondents. Based on the objectives of the study, separate questionnaires were designed for both the SME respondents and the banking staff respondents. Structured questions were used on the questionnaire so as to obtain specific responses on specific areas of the study. Open ended questions were also used where the researcher required detailed responses. The questionnaires were administered by the researcher with the help of two identified assistants from the location who were trained by the researcher.

Validity and Reliability

The researcher administered the questionnaires to obtain reference data that couldn't be obtained in one sitting. The validity of the questionnaires was measured by giving the questionnaire to the researcher's supervisor together with 5 different people who rated the relevance of the questions there in using the Likert scale method. The content validity index (CVI) of each instrument was then calculated. In this case, the CVI was 0.9 which exceeded the scientific threshold of

0.7. The researcher also followed up with the relevant respondents for clarification on areas where information supplied on the questionnaire elicited doubts.

Data Gathering Procedures

The University identification card was used by the researcher to identify him to the respondents for purposes of data collection.

The researcher with the assistance of the identified research assistants explained the content of the questionnaire to the respondent and sought a timeframe within which the respondent would find it convenient to respond. The questionnaires were then distributed to respondents and collected on the respective agreed dates. Prior to the researcher leaving the premises of the respondent, the researcher went through the content of the response to identify areas of inconsistency and sought clarification with the respondents.

Data Analysis

The data collected was analyzed using frequencies and percentages. The statistical Package for Social Scientists (SPSS) version 12.0 for windows was used to create frequencies, percentages and pie charts. Frequencies and percentages were used because they are suitable for analyzing numeric, discrete and continuous data. Pie charts were used because they are suitable for comparison.

Ethical Considerations

The researcher used the University ID card and the introduction letter to introduce himself to the involved entities during the course of this research. The researcher then went on to obtain the consent of the respondents prior to soliciting for the relevant information relating to this research. He then undertook to assure the respondent that the information obtained would be treated in confidence and used only for this academic purpose.

Limitations

The researcher encountered the following limitations in the course of the study;

1. Some questionnaires administered to the SMEs proprietors were not completed.
2. The administration of the questionnaires was also difficult considering that the researcher couldn't manage to visit all the BIs and SMEs and often had to utilize the assistance of other people which risked compromising the reliability of the data.
3. A sizeable portion of SMEs weren't manned by the real owners but rather the employees who shied away from completing the questionnaires for fear of giving the wrong information.
4. The staffs of selected banks are ordinarily busy with their routines and didn't have time to attend to interviews or complete the questionnaire.

CHAPTER FOUR

PRESENTATION, ANALYSIS AND INTERPRETATION OF DATA

Introduction

The aim of the study was to identify how the banking services have influenced the status of the SMEs sector in Ruiru town.

This chapter deals with the systematic presentation, analysis and interpretation of the data collected during the study.

The study managed to capture a sample size of 104 respondents of the targeted 110 respondents; of these, 20 were staff from the selected banks while the rest 84 consisted of the SMEs respondents.

The researcher-devised questionnaires were successfully conducted and responded.

The main tools used for analysis included of tables for frequency and percentage analysis and charts for comparisons

The presentation and analysis of the findings was conducted in accordance with the objectives enunciated in chapter one and encapsulate the information collected from the two groups of respondents i.e.:

- Proprietors or managers of SMEs in Ruiru town
- Members of staff of the selected banking institutions with outlets in Ruiru town.

Forms of SMEs Ownership

The proprietors or managers of SMEs were asked to respond to questions relating to the ownership of their firms. The mode of business ownership provides an indication to the level of formality and reflects on its readiness to benefit from services extended by the banks. This is because many banks prefer to deal with organizations which are duly registered because it affords them a sense of contract enforceability.

The findings are presented by table 1.1 below;

Ownership	Percentage
Individual	52%
Family	18%
Partnership	15%
Private Limited Company	15%

Table 1.1: Forms of SMEs ownership

Source: Researchers' Fieldwork

Table 1.1 above shows that the majority of the firms (52.0 percent) are owned by individuals. The rest of the SMEs in the sample were either under family ownership (18%) Partnership (15%) or had limited company status (15%)

This has a major bearing on the accessibility of these firms to the services offered by banks as they are perceived as lacking in structures and formality.

Close examination of the reasons for preference for individual ownership revealed that the owners have three primary arguments. First, the owners of SMEs felt that the other forms of business ownership usually require more financial outlays and better business training skills than they had. The second reason was the fear of being encumbered with complex legal and administrative procedures. Finally, the owners of the firms were of the view that all aspects of the business can be managed effectively by an individual.

This observation correspond with the World Bank's *Doing business* report(2007) which noted that for SMEs, the decision to remain informal is deliberate, because the costs and procedural burden of joining the formal sector outweighs the benefits of staying in the informal sector.

Banking services offered to the SMEs

From table 1.2 below, it is evident that the banks extend a variety of services to the SMEs sector in the area. 100% of the bank staff respondents indicated that loan facilities are extended to the SMEs customers by their institutions while a similar percentage said that savings services which basically afford safe cash handling facility through overnight deposits or short - term saving facility is also available. This is attributed to the fact that the two services are the basis on which the banks trade with its clients for profit. Banks are by law deposit-taking and lending the same funds at a prescribed interest rate is one popular means of generating more revenue. With returns from government securities and Nairobi Stocks Exchange (NSE) investments declining, lending offers an alternative means of investment for BIs.

It is also evident that all banks in the area offer overdraft facilities to the SMEs. Overdraft facility is useful where businesses are faced with a need to bridge urgent cash flow gap. All the banks also offer Business advisory service which involves following up the progress of the investors' projects and offering professional consultancy on areas of financing and management therefore enhancing project's stability. By so doing, the client is able to make prompt loan repayments as well as ensure long term profitability of the venture.

As depicted by the table 1.2 below, half of the banks in the area offer insurance services to SMEs. This tally with the observation by the CBK economic review (2008) that the concept of banc assurance is a new phenomenon in Kenya and only a handful banking institutions have gone that route for fear of losses which is largely attributed to lack of experience.

Service Type	Frequency	Percentage
Savings services	20	100%
Loans facilities	20	100%
Overdraft Facilities	20	100%
Business advisory	20	100%
Insurance services	10	50%

Table 1.2: Services offered by banks to the SMEs

Source: Researcher's fieldwork

Utilization of Banking services by SMEs

By determining the extent to which SMEs in the area utilize the available banking services, it reflects on the degree to which specific services are needed by SMEs in the area. It is also indicative of possible bottlenecks in the service delivery by the banks to the SMEs which assists the policy formulators in designing appropriate remedial measures.

Figure 1.2 below summarizes the findings;

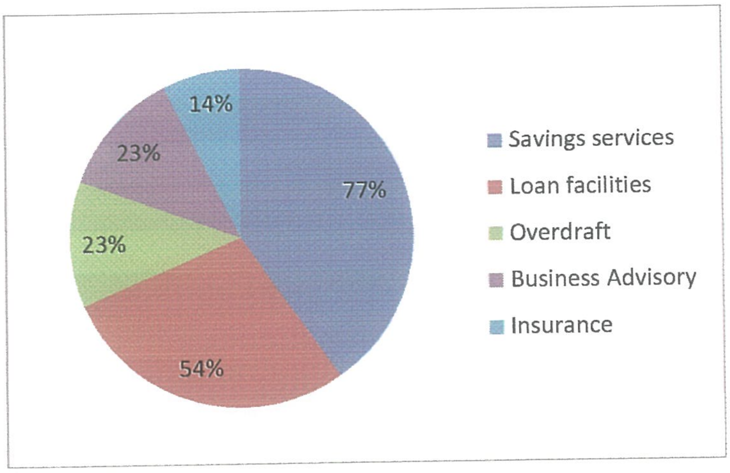

Figure 1.2: How SMEs have utilized the services extended by banks.

Source: Researchers' Fieldwork

The figure 1.2 above shows that savings services are most popular among the SMEs community in the town with 77% of the respondents. This means that the SMEs sector has a savings culture. They want to secure their money in order to accumulate sufficient funds for future business expansion because not many of them are able to qualify for lending facilities available in the banks. It also implies that the service is inherently cheap and readily available. This has come about as a result of banks liberalizing account-opening facilities and reducing the account-operating charges. This corresponds with the Central Bank of Kenya Economic review report (2007).

Slightly over half (54%) of the respondents indicated that they utilize the loan facilities offered by the banks. This is an interesting observation bearing in mind that 100% of the banks offers loan facilities to SMEs community in the town. This implies that sizeable SMEs respondents are still not enthusiastic to take up loans. This trend was attributed to the fact that bank loans are accompanied by astronomical borrowing costs in form of high interest rates and insurance costs which oscillates between 16 – 18% per annum. Furthermore, majority of the SMEs are not registered and the banks aren't ready to risk their money by trading with "informal" organizations. It is for that reason that SMEs proprietors prefer to utilize their saved earnings or seek for funds from other informal sources to do business. This trend is compounded further by the fact that most SMEs business patterns aren't predictable because they largely depend on factors beyond their control such as weather conditions, inflation levels as well as security situation which hampers their ability to draw up robust business plans which is a condition before BIs advances the loans. This observation tallies with the USAID report on SMEs financing (2009) which noted that most financiers perceive SMEs lending as a risky venture because of the high failure rate in the segment. To cushion themselves against the risk, they inevitably charge higher risk premiums which ultimately keeps SMEs at bay.

23% of the respondents said that they utilized overdraft facilities. The reason for such a low turnout is that the facility is ordinarily expensive especially to the SMEs whose business turnover is relatively low and therefore cannot keep pace with the financing costs involved. Further, the short grace period offered to repay the same was a deterrent for many who said their cash flow patterns were so unpredictable to afford the facility. Some SMEs owners didn't know that the service exists while others associated it with big corporate entities that are in a position to do roaring business in most cases involving cross-border transactions.

The researcher also found that only a meager 23% of the respondents acknowledged receiving business advisory services from their banks. Majority of the respondents said that even when they got loans, rarely did banks bother to monitor how the disbursed funds are utilized as long as the loan is paid back. This often resulted to diversion of funds considering the scarcity vis-à-vis the competing needs.

14% of the respondents indicated that they obtained insurance services from their banks. Majority said they weren't aware that banks offered insurance services while others indicated they preferred to insure their businesses through the mainstream insurance companies rather than through the bank which was already "milking them dry".

The above findings reinforce the observation by Morriset (2000) that majority of SMEs are not able to access the value adding services from the bank because of the procedural and financial burdens involved. Nonetheless, majority of SMEs are able to appropriate the generic services offered by the banks because they are cheap and do not involve a lot of requirements.

Gains realized by SMEs

In assessing the influence that banks have had on the SMEs sector in the area, it was necessary to find out how individual SMEs have benefited from the services extended to them by these banks. This was accomplished by having the selected SMEs proprietors and managers give an indication on the improvement their entities have experienced by utilizing the services rendered by the banks as measured against the key business critical success factors. The figure 1.3 below summarizes the findings:

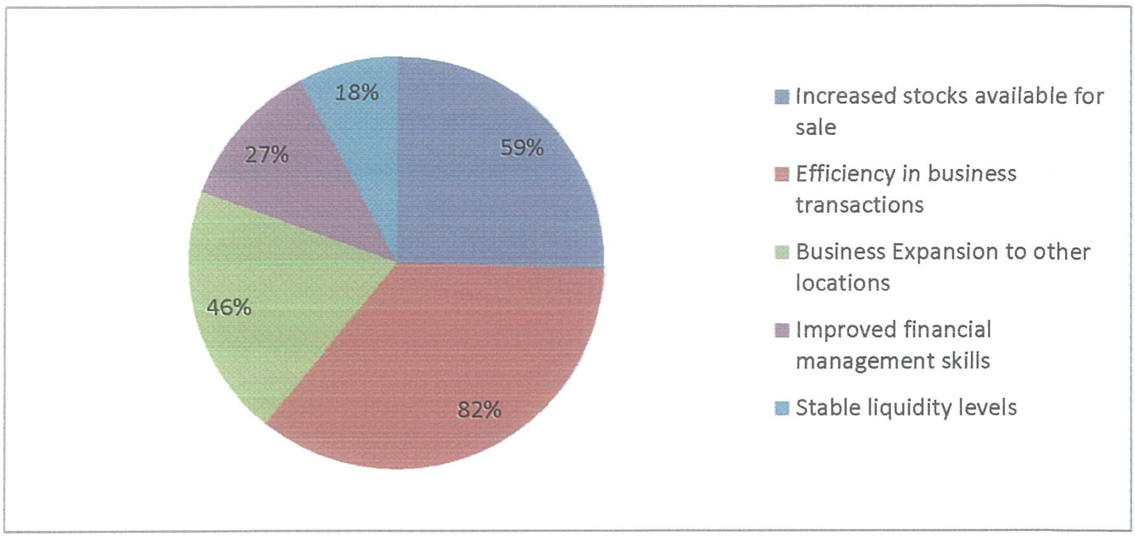

Figure 1.3: Gains realized by SMEs.

Source: Researchers' Fieldwork

The above illustration indicates that 82% of the respondents are able to efficiently handle their business transactions through the banks. This is followed by 59% who have observed their business investments increase in terms of stock levels available for sale. 46% of the respondents acknowledged that existence of banks in the area has assisted them expand their business ventures to other locations by way of opening other branch outlets and distribution centers. 27% said they have been trained by their banks on how to prudently manage their business' financial resources and were better off in making financial/investment decisions. The researcher also observed that a low 18% have attained a stable liquidity level for their business entities.

The implication of the above findings is that majority of SMEs are able to execute their business transactions e.g. payments, deposits and withdrawals promptly and safely at minimal fee. This is usually accomplished through check payments, direct transfers, mobile money transfer, trade financing facilities and internet banking which afforded SMEs owners the facility to transact and monitor their transactions at the comfort of their desks. SMEs proprietors also saw the practice of banking the money daily as a means of averting the temptation to inadvertently spend the business funds on personal needs. This was depicted by a business lady (GO) who commented "because I bank the business money daily, there is no chance of "eating" the money on domestic requirements". By operating bank accounts, SME proprietors are able to bank the collections daily and avert chances of spending the money on personal needs.

A sizeable 59% of the respondents indicated that they have realized a marked improvement in their business investments in terms of stocks available for sale. Majority of this category said that this has come as a result of the loans they obtained from the BIs for restocking their businesses and were now making more profits by turning over huge volumes. One business lady (MW) who owns a boutique said "initially, I couldn't manage to travel to Dubai and Turkey to import clothes for sale since the indigenous big banks couldn't give me a business loan as they viewed my business as small and risky. With the arrival of the '*common man's banks'* I have expanded my stocks ten-fold as I am able to access money to go shopping not only to Dubai and Turkey but also China". This is a clear indication that businesses have been boosted.

46% attributed the support of the BIs for them to have expanded their operations to other areas by opening new branch outlets and distribution centers. An agribusiness man (KK) who has operated for the last 10 years said "For the last 4 years, I have managed to open additional distribution centers at Gewa Township, Thika town, Juja and Githurai courtesy of the funding I receive from my bank".

According to the above findings, banks have performed dismally in training the SMEs investors on matters of financial management as only 27% of the respondents have benefited in the area. Only 18% said that BIs have assisted them to attain stable liquidity levels.

The above finding correspond with the observation by Helms (2001) that banks recognize the profit potential possessed by the SMEs sector and are willing to partner with the sector in doing business. However, they largely adopt a cautious approach because they too understand the risks involved.

Challenges experienced by Banks while dealing with SMEs

Many a times, banks are blamed for not playing a supportive role in the campaign to establish robust SME sector that is uniquely regarded the backbone of many economies. Nonetheless, empirical studies have shown that banks also experience inherent limitations while rendering their services to the sector. The table below summarizes some of the problems experienced by banks in Ruiru town while dealing with SMEs:

In determining the challenges faced by the banks in offering their services to the SMEs in the area, the 20 selected banking staff respondents were asked to use their experience in scoring each identified problem on a scale of 1-10; where 1 denoted least severe and 10 denoted most severe. The results were as tabulated below ranking from most severe to least severe challenge.

Identified problem	**Score**	**Rank**
Inadequate collateral against loans	150	1
Default risk level on advanced loans	144	2
Inadequate credit information on SMEs	137	3
Inadequate business skills to SMEs owners	95	4
Competition from rival banks	87	5

Table1.3: Challenges experienced by Banks in offering their services to SMEs

Source: Researchers' Fieldwork

From table 1.3 above, inadequate collateral levels against loans is the biggest impediment faced by the banks in serving the SMEs sector. This is followed by high risk of default on advanced loans and insufficient credit information on SMEs in that order. Less than half of the respondents indicated that inadequate business skills among SMEs owners and interbank competition paused challenges to the banks.

The observation shown above reinforces the findings by Porteous (2003) that owing to their small asset base, most of the SMEs cannot raise sufficient securities for the loans applied for and banks are finding it a risky venture to give loans that aren't adequately secured usually because of the high levels of non-performing loans in their books. It is understandable that most SMEs are individually owned and don't have a large asset base to secure the required loans and are therefore being forced to use their savings for business expansion. This limits their expansion capacity as well as business opportunity for the BIs.

The risk of default on loans advanced to SMEs also jolts the banks. Experience indicates that SMEs have got relatively unsteady cash flow patterns which make them susceptible to inability to meet loan repayment obligations. Majority of them are already highly geared with multiple debts from different sources which they don't disclose to the BIs at the time of applying for the loans. With banks pursuing the key objective of reducing NPLs on their books, they are obliged to be more vigilant in advancing loans to SMEs whose credit history is hard to establish. Frank Griffiths (Managing Director, Barclays Bank of Uganda) once said that "It is important to appreciate the banker's point of view. Bankers are in business, like anyone else, to make profits for their shareholders. But they also have a duty to their depositors and thus are quite naturally averse to taking undue risks. Whilst a bank's job is to assist in financial intermediation, it is not obliged to lend to anyone that it does not wish to do business with".

Banks in the area admitted that credit information of SMEs is scanty. Majority of the SMEs are also not willing to disclose such vital information to banks while seeking funding as they feel this will jeopardize their chances of getting the facility. BIs have also not established a mechanism to share credit information concerning their customers which would reduce chances of approving bad loans. More so, many SMEs are first-time borrowers meaning they have no prior credit history. The result is that banks aren't able to adequately assess the creditworthiness of the SMEs which explains why BIs take a cautious approach while dealing with the SMEs fraternity.

From table 1.3 above, banks also face the challenge whereby some SMEs proprietors are not very well versed with business management skills. This is supported by the observation by Dengate (2003) that many SMEs managers lack in managerial training and usually apply trial and error approach to business management which jeopardizes the profitability and innovation. Indeed, some of the owners are O-level graduates and have not undertaken any business course to horn their skills. They have learnt to do business through experience and can't therefore make some technical decisions. They may also not be in a position to hire professional consultants to assist them because of their limited cash flow position. Some admitted that they undertook business as a hobby or as an alternative means of survival after missing out of the competitive job market. Such businesses face the imminent risk of collapsing at any moment even after BIs have pumped money into them. It is for that reason the banks should find it necessary to train these SMEs proprietors on matters of business management since they too are stakeholders.

Limitations experienced by SMEs while dealing with the Banks

According to Nadvi (1995), even when the financial services are available through BIs, other related frustrations are still experienced by SME sector which prevent it from fully appropriating the benefits that come with it. The researcher set out to identify these drawbacks the findings of which are presented on figure 1.4 below:

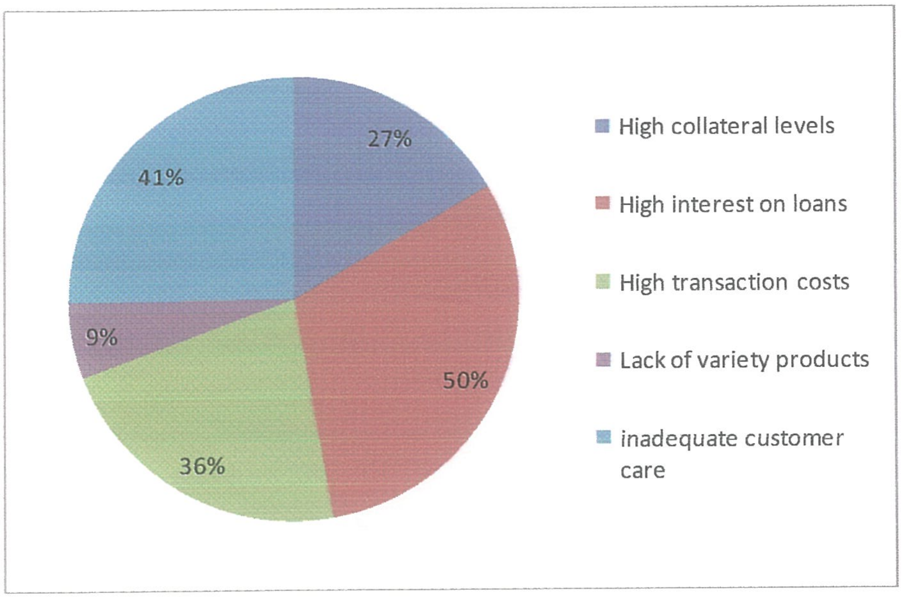

Figure 1.4: Limitations experienced by SMEs while dealing with Banks.
Source: Researchers' Fieldwork

From figure 1.4 above, it is evident that half of the 84 SMEs respondents indicated that interest rates demanded by banks against loans advanced to them are astronomical and therefore prohibitive for their progress. This is followed by 41% who said that the level of customer care given by BIs is inadequate. 36% cited high transaction costs as a major hindrance in doing business with the BIs in the area while 27% of the respondents decried the high collateral threshold before loan approvals are secured. An insignificant 9% however indicated that banks don't avail a wide variety of business-tailored product to the SMEs sector.

The above pattern implies that in the perspective of SMEs, banks charge astronomical interest rates on the loans advanced to them. As a result, they find it prohibitive since majority are not in a position to keep pace with repayment patterns

This finding is in unison with the observation by Duursma (2006) who noted that majority of BIs do not give preferential rates of interest on loans to SMEs but rather apply similar rates as those charged to big corporate. The result is that many SMEs whose turnover is unpredictable are excluded from financial accessibility bracket.

Also, a sizeable portion of the SMEs get frustrated by poor customer care adopted by the BIs which borders on time wastage and non disclosure of vital information for decision making. An SME owner (JKM) said "Banks usually do not supply all the required information to the small borrowers, except the lending rates – that is, other fees are not mentioned. When these are added up, the cost of borrowing escalates". In another instance, one SME proprietor (JBM) said "I applied for a loan of Kshs five hundred thousand to go to China for business but after 3 weeks of persistently following up, I was informed I could only get Kshs 200,000 which wasn't enough for my budgeted trip....I ended up abandoning the whole project because first the money wasn't enough and I had wasted a lot of time". This clearly is a statement from a dissatisfied customer.

The high transaction costs experienced by SMEs stem from the fact that the sizes of transactions they carry out are normally numerous and repetitive.

The high collateral level requirement by banks is attributed to the fact that the banks are not able to adequately assess the credit worthiness of the SMEs due to scanty credit history. Some of the SMEs are first-time borrowers and therefore have no credit information for reference at all. Majority of the SMEs have limited turnover and their sustained profitability is usually not guaranteed considering their erratic cash flows which is highly dependent on weather conditions and other factors beyond their control. All these factors makes the banks adopt a cautious approach in dealing with the SMEs and offers to mitigate the possibilities of loss by asking for high collateral to guarantee loans.

As indicated above, majority of the SMEs admitted that banks have a variety of business-tailored products available to SMEs with some banks like Barclays Bank of Kenya and FINA bank establishing SME-banking as a product specifically tailored to meet the SMEs financing requirements.

Strategies adopted by banks in deepening service delivery to SMEs.

In our effort to determine the strategies put in place by the banks in deepening service delivery to the SMEs in the area, the 20 selected banking staff respondents were asked to use their experience in scoring their individual institution's performance on a scale of 1-10 based on specified parametric benchmarks; where 1 denoted poor and 10 denoted excellent in terms of performance (this means the total possible score was 200 points per parameter). The findings were as tabulated below.

Strategy	Points (out of 200)	Rank
Effective customer care	159	1
Enhanced loan processing time	140	2
Competitive interest rates on loans	139	3
Affordable collateral against lending	131	4
Availability of business-tailored products	119	5
Training on matters of business management	95	6

Table 1.4: Strategies adopted by banks in deepening service delivery to the SMEs.

Source: Researchers' Fieldwork

The table 1.4 above indicates that banks largely prefer effective customer care as a strategy to woo and possibly retain the SME clientele. In the face of the existing cut-throat competition within the banking industry, banks in the area are also cutting on loan- processing time on the qualifying applications. Banks are also extending competitive interest rates on disbursed loans as well as lowering the threshold on collateral requirements for advanced loans. A sizeable portion is also availing wider variety of SMEs-tailored business packages in a bid to afford the investors alternative means of doing business. Banks have nonetheless under-performed on training SMEs investors on matters of business management.

This is a key observation considering the government policy of integrating the SMEs sector into the Kenya's economic grid that was promulgated in 2007.

The implication of the above observation is that banks have realized the need to take a more keen interest in enhancing customer satisfaction and retention through offering superior customer services. It is with this in mind that banks have increased their staffing capacity to expedite on service delivery. They are also engaging them in frequent training so as to equip them with proper customer care skills. Heavy investment in information technology has also afforded the ability by banks to offer one-stop banking facility to their clients.

BIs have also sought to reduce the loan processing time to the qualifying clients in an effort to make funds available to clients without delays. Some banks revealed that they already have a policy to inform the client about the outcome of their loan application within 48 hrs of applying. According to the above analysis, the researcher infers that banks also have adopted a policy to extend both competitive interest rates and affordable collateral (security) against loans issued to SMEs clients in an effort to improve their growth and expansion in the area.

Banks are however reluctant in training SMEs clients on matters of business management with this parameter returning a 95 point score among the banking staff respondents. This is attributed to the fact that banks normally deal with a client base with diverse requirements which may be difficult to address. Banks also leave the training function to the SMEs associations and advocacy groups

CHAPTER FIVE

FINDINGS, CONCLUSION AND RECOMMENDATIONS.

Introduction

The purpose of the study was to establish how the banking services have influenced the status of the SMEs sector in Ruiru town. The objectives of the study were to; identify different forms of SMEs ownership in the area, identify different services offered to SMEs by banks and assess the extent of utilization in the sector, identify the gains realized by SME sector in the area as a result of the services extended by the banks, identify challenges experienced by both banks and SMEs while doing business together and finally establishing the strategies adopted by the banks in deepening service delivery to the SMEs.

This chapter therefore presents the findings, conclusion and recommendations made from the study.

FINDINGS

The findings of the study are summarized below:

1. Majority of the SMEs operating in Ruiru town are individually owned. This is attributed to the following three reasons; first, the owners of SMEs felt that the other forms of business ownership usually require more financial outlays and better business training skills than they had. The second reason was the fear of being encumbered with complex legal and administrative procedures. Finally, the owners of the firms were of the view that all aspects of the business can be managed effectively by an individual.
2. In recognition of the profit potential possessed by the sector, banks in the area offer a wide variety of banking services to the SMEs sector.

3. In spite of banks extending a wide variety of services to the SMEs sector in the area, majority of the SMEs are not able to take advantage of the value-adding services e.g. credit, business advisory and bank assurance. They rather utilize the savings service which is regarded as generic. This is attributed to the factors like high finance costs involved as well as inadequate knowledge about existence of specific services by SMEs.
4. SMEs have benefited from services offered by BIs by being able to efficiently execute their business transactions, increasing turnover as well as expanding to other areas. However, no significant gain has been realized by SMEs in the areas of training in financial management and attaining stable liquidity level.
5. Inadequate collateral to secure loans by SMEs is the biggest impediment experienced by the banks in serving the SMEs in the area. Other significant challenges include; high default risk on loans advanced as well as lack of credit information on SMEs borrowers.
6. High interest rates applied on loans are the top most obstacles experienced by SMEs while dealing with banks in the area. Other notable challenges include of inadequate customer service and high transaction costs.
7. Banks have put in place strategies to deepen their service delivery to the SMEs sector. Key among the strategies include of effective customer service, reducing loan processing time to qualifying clients, offering competitive interest rates on loans as well as offering negotiated collateral on loans.

CONCLUSIONS

From the study, it is evident that banks recognize the profit potential possessed by the SMEs sector and that is the reason for the banks to deploy significantly wide variety of services to this sector. As a result, SMEs sector in the area has markedly benefited from the banking services offered by the BIs although the high interest rates on credit remains the top most impediment on access to financial services .

On the other hand, banks also recognize the risk potential that the SMEs sector portend in terms of lack of structures, low asset base, financial illiquidity as well as lack of adequate credit history. Since banks are accountable both to depositors and shareholders, they have largely adopted a cautious approach especially in matters of credit facilities. Banks have nonetheless liberalized the account-operating facilities which explain the high utilization level by the SMEs.

Despite the challenges experienced by the banks, they have put in place key strategies to better serve the SMEs sector.

RECOMMENDATIONS

From the study, the researcher makes the following recommendations:

1. The policy makers should encourage SMEs to formalize their operations by simplifying both the procedural and regulatory obstacles associated with business registration, tax compliance and licensing.
2. Banks should critically evaluate the value of the services offered by them to the SMEs sector as well as the affordability by the sector by involving the target beneficiaries for purposes of realizing value-addition.
3. Banks should make an effort to bridge the disparity gap between the services offered to SMEs sector by sensitizing the SMEs proprietors on availability and affordability of their services.
4. Both the banks together with the SMEs associations and advocacy groups should facilitate adequate training of the SMEs proprietors and managers on matters of financial management so as to position them well for decision making in a complex business environment.
5. The policy makers should implement the credit referencing systems in the banking sector to assist on evaluating the client's credit worthiness and use the information to assess the collateral on loan facilities as well default risks on individual basis.
6. Banks should extend preferential interest rates on loans given to SMEs based on factors like credit history as well as turnover levels.

7. The strategies set by banks for enhanced service delivery to SMEs should be implemented expeditiously and systematically to ensure that the benefits accrues to the target sector.

Areas for further Research

1. The level of Information Technology access and use of by the SMEs sector in Kenya.
2. Globalization and SMEs development in Kenya
3. Women Entrepreneurs and SMEs sector development in Kenya

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QUESTIONNAIRE FOR THE SELECTED BANK STAFF RESPONDENTS

Dear Sir/Madam,

I am a student of Kampala International University pursuing Masters of Business Administration.

In partial fulfillment of the requirement for the award of this degree, I am carrying out a research study entitled "Banking services and status of Small and Medium scale Enterprises (SME's) in Ruiru town". You have been selected to participate in this study and are therefore requested to answer the questions below. The information provided will strictly be used for academic purposes and will be treated with utmost confidentiality.

Tick where appropriate.

1. What nature of services does your institution offer to the SME community?

Savings services	☐	Business advisory services	☐
Loan facilities	☐	Insurance services	☐
Overdraft facilities	☐	others (specify)	☐

2. On a scale of 1- 10, rate the magnitude of the below challenges as experienced by your institution in rendering the services to SMEs in the area; (where 1 = least severe and 10 = most severe).

Default risk levels on loans advanced to SMEs	☐
Inadequate credit information concerning SMEs	☐
Inadequate collateral values	☐
Inadequate managerial skills by SMEs Managers	☐
Competition from rival banks	☐

QUESTIONNAIRE FOR THE SELECTED SME RESPONDENTS

Dear Sir/Madam,

I am a student of Kampala International University pursuing Masters of Business Administration.

In partial fulfillment of the requirement for the award of this degree, I am carrying out a research study entitled "Banking services and status of Small and Medium scale Enterprises (SME's) in Ruiru town". You have been selected to participate in this study and are therefore requested to answer the questions below. The information provided will strictly be used for academic purposes and will be treated with utmost confidentiality.

Tick where appropriate.

1. What is the form of ownership for your business?

Individual ☐ Partnership ☐

Family-owned ☐ Limited Company ☐

2. Which services listed below do you utilize from your bank in the course of doing business?

Savings services ☐

Loan facilities ☐

Overdraft facilities ☐

Business advisory services ☐

Insurance services ☐

3. What benefits has your business realized by utilizing the services offered by your bank (above)?

Increased stocks available for sale ☐

Efficiency in business transactions ☐

Business expansion to other locations ☐

Improved financial management skills ☐

RESEARCHER'S CURRICULUM VITAE

Personal Profile

Age	33 years
Nationality	Kenyan
Contact	+254723995085

Educational Background

Masters Degree	Masters of Business Administration (Continuing) Kampala International University, Uganda
First Degree	Bachelor of Commerce (Accounting) Second Class (Upper) 1997 - 2000 Kenyatta University, Nairobi, Kenya

Work Experience

The researcher has acquired ten years progressive working experience in the field of accountancy and finance with various organizations both within and outside Kenya. Presently, the researcher works as Chief Finance Officer (CFO) with an International organization.

Other Relevant Data

The researcher has attained the Certified Public Accountant of Kenya (C.P.A.K) status and is also a member of the Institute of Certified Public Accountants of Kenya.