DETERMINANTS OF CHOICE OF SOURCE OF ENtrepreneurial finance for small and medium sized enterprises. Survey of Thika District, kenya

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Determinants of Choice of Source of Entrepreneurial Finance for Small and Medium Size Enterprises. Survey of Thika, District Kenya

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A thesis submitted in partial fulfillment for the degree of Doctor of Philosophy in Entrepreneurship in the Jomo Kenyatta University of Agriculture and Technology

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DECLARATION

This thesis is my original work and has not been presented for a degree in any other university.

Signature…………………………………… Date……………………

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This thesis has been submitted for examination with our approval as University Supervisors.

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Signature…………………………………… Date……………………

Dr. John Kihoro
JKUAT, Kenya
DEDICATION

This thesis is dedicated to my late Grandfather Gatama, Grandmother Wathimu, my parents Josephat Njeru and Cecily Njeru, my husband Nyaga John and daughter Lorna Mumbi and my son Justin Mwendwa. They have been very supportive and cheered me on even when I felt like giving up. May God bless them all.
ACKNOWLEDGEMENT

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### ACRONYMS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>ASCRA’s</td>
<td>Accumulating Savings and Credit Organizations</td>
</tr>
<tr>
<td>ATF</td>
<td>African Task Force</td>
</tr>
<tr>
<td>CamCCUL</td>
<td>Cameroon Cooperative Credit Union League</td>
</tr>
<tr>
<td>DFIs</td>
<td>Development Financial Institutions</td>
</tr>
<tr>
<td>DTOT</td>
<td>Dynamic Trade-Off Theory</td>
</tr>
<tr>
<td>FDIs</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>IDRC</td>
<td>International Development Research Corporation</td>
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<td>MFIs</td>
<td>Microfinance Institutions</td>
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<td>Modigliani and Miller</td>
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<td>POT</td>
<td>Pecking Order Theory</td>
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<td>RBT</td>
<td>Resource Based Theory</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<td>ROSCA’s</td>
<td>Rotating Savings and Credit Associations</td>
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<tr>
<td>RUIG-GIAN</td>
<td>Geneva International Academic Network</td>
</tr>
<tr>
<td>SACCOs</td>
<td>Savings and Credit Co-operative Societies</td>
</tr>
<tr>
<td>SBA</td>
<td>Strategic Business Advisors Africa Ltd</td>
</tr>
<tr>
<td>SME</td>
<td>Small- and Medium-Sized Enterprise</td>
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<tr>
<td>TBD</td>
<td>Thika Business Directory</td>
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<tr>
<td>UNEP FI</td>
<td>United Nations Environment Programme Financial Institutions Initiative</td>
</tr>
<tr>
<td>WWF</td>
<td>World Wide Fund for Nature</td>
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DEFINITION OF TERMS

**Entrepreneurial Finance** are financial resources used by entrepreneurs in the financial planning process of making financial decisions for new and growing ventures (Broembsen and Herrington, 2005).

**The entrepreneur** is an entity distinct from business owners and managers, and these are individuals whose function is to carry out new combinations of means of production and entrepreneurial activities (Carland *et al.*, 1984).

**Entrepreneurship** in this study will be defined as investments done in response to an identified opportunity (e.g. an opportunity to earn more money), which is referred to as opportunity entrepreneurship and these are the type of firm most likely to contribute to economic growth (Broembsen and Herrington, 2005).

**SMEs Size** is defined as follows by Kenya Association of Manufacturers [KAM], (1999):
<table>
<thead>
<tr>
<th>ENTITY (Trade, service, industry or business activity)</th>
<th>NO. OF EMPLOYEES/PEOPLE</th>
<th>ANNUAL TURNOVER LIMIT</th>
<th>INVESTMENT IN PLANT AND MACHINERY + REGISTERED CAPITAL</th>
<th>EQUIPMENT INVESTMENT + REGISTERED CAPITAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro enterprise</td>
<td>Less than 10 people</td>
<td>Not exceeding Ksh. 500,000</td>
<td>Not exceeding Ksh. 10M</td>
<td>Not exceeding Ksh. 5M</td>
</tr>
<tr>
<td>Small enterprise</td>
<td>More than 10 but less than 50</td>
<td>Between Ksh. 500,000 to Ksh. 5M</td>
<td>More than 10M but less than 50M</td>
<td>More than 5M but less than 20M</td>
</tr>
<tr>
<td>Medium Enterprise</td>
<td>More than 50 but less than 100</td>
<td>Between Ksh. 5M to 800M</td>
<td>Not specified in the draft bill</td>
<td>Not specified in the draft bill</td>
</tr>
<tr>
<td>Micro, Small and Medium (MSME)</td>
<td>Not less than 100</td>
<td>Not specified</td>
<td>Not specified</td>
<td>Not specified</td>
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**Information availability** is the general awareness of financial resources available through available mediums of communication eg print media radio stations and others.

**Purposes of finance** are the activities for which financial resources are being sought by the entrepreneur. They include meeting working capital requirements, equipment acquisition among others.

**Costs of finance** are all the expenses that the entrepreneur must meet so as to acquire a particular kind of finance. They include interest rates, calling and travelling costs among others.
Choice of Source of

Entrepreneurial Finance: This refers to an entrepreneur’s ability to source adequate debt or equity capital at an affordable cost of capital, irrespective of firm size, to serve the purpose intended, and with minimum of information asymmetry in the process. There should be enablers in the macro-economic environment that facilitate this process of capital acquisition.
ABSTRACT

This study examines the determinants of choice of source of entrepreneurial finance for small and medium sized enterprises (SMEs) in Thika district of Kenya. The study had four objectives which were to evaluate the effect of firm size on the choice of source of entrepreneurial finance, investigate the effect of information availability on the choice of source to entrepreneurial finance; to evaluate the effect of cost of the source of finance on the choice of source of entrepreneurial finance and to assess the effect of purpose of finance on SMEs choice of source of entrepreneurial finance.

This study adopted mixed research design. The population of interest was a total of approximately 800 SMEs. Stratified random sampling was used and 259 SMEs were selected. The survey instrument was a questionnaire administered to the owners or finance managers or their designated backups.

Analysis of the data was by descriptive statistics and inferential statistics. Logistic regression determined the probability of the entrepreneur choosing between equity and debt financing options. The study determined that information availability, purpose of finance and cost influenced the choice of source of entrepreneurial finance while size had no influence.

The study recommended that small- and medium-sized enterprises focus a lot more on optimizing their size in order to maximize on the potential to increase value along their chain of activities and enhance profitability. On information availability the study recommended that the entrepreneurs should adopt medium of communication that would lower the perceived risk in financial transactions especially that
perceived in assuming debt capital. The recommendation on cost revolved around SMEs being able to access different sources of finance shifting from the more convenient forms of debt such as overdrafts to alternative forms of borrowings that have less severe penalties such as from family and friends. Further the study recommended that SMEs clearly assess the company’s current and future strategy to determine finance purposes that would give the SME a competitive advantage; that is entrepreneurial finance.
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background

In both developing and developed countries, entrepreneurial ventures play important roles in the process of industrialization and economic growth. Apart from increasing per capita income and output, entrepreneurial firms create employment opportunities, enhance regional economic balance through industrial dispersal and generally promote effective resource utilization considered critical to engineering economic development and growth (Ogujiuba et al., 2004).

The Small and Medium Enterprise (SME) sector is the backbone of the European economy, accounting for over 66% of the exports, employing over 70% of the available workforce and generating 56.2% of its private sector turnover (Anand Kumar and Newport, 2005). The extent of this sector's economic consequence is highlighted by the fact that 99.8% of the 17.9 million enterprises in the European Union are SMEs (Anand Kumar and Newport, 2005). Research has shown that choice of source of entrepreneurial finance is the most significant factor contributing to the growth of small firms (Brown et al., 2008).

The 1999 GOK baseline survey indicated that there were 1.3 million micro and small enterprises (MSEs) employing 2.3 million people and generating as much as 18% of Kenya’s Gross Domestic Product (GDP) (Mullei and Bokea 1999). The contribution of SMEs is more than double that of the large manufacturing sector, which stands at 7% of the GDP (Government of Kenya [GoK], 1999).
Overall, SMEs create 75% of all new jobs. Estimates based on the 2003 baseline survey show that, in the year 2002, the SME sector employed about 5,086,400 people, up from 4,624,400 in 2001. This was an increase of 462,000 persons and consisted of 74.2% of total national employment (GoK, 1999).

The long-term growth and competitiveness of SMEs are compromised by the constraints on their choice of source of alternative forms of finance, among other systematic and institutional problems in developing countries. Limited access of SMEs to credit and financial services has been identified as one of the most important supply constraints confronting the sector in Kenya (Soderbom, 2001). As a result, SMEs share of financing resources is disproportionately less than their relative importance in domestic employment and to the value added.

Furthermore, the majority of SMEs have been found to be heavily dependent on bank finance (Benneworth, 2004). The differences in institutional arrangements and financial markets between developed and developing countries actually merit the need to look at the issue of SMEs financing from the perspective of developing economies, especially within the context of sub-Saharan Africa, such as Kenya. Small and Medium Enterprise in Kenya may exhibit a limited choice of source of entrepreneurial finance due to the underdevelopment.

Ngehnevu and Nembo (2010) conducted a study of which one of the objectives was to determine if there were underlying factors such as size of the operations, securable wealth and gender of application that influenced the ability to secure a loan. The findings indicated that securing micro-financing by SMEs was positively related to size of the firm, purpose of financing and cost of financing. Gender was seen not to have any influence on the ability to access finance.
Migiro (2006) conducted an empirical study relating Kenyan manufacturing SMEs’ finance needs to information on alternative sources of finance. The findings indicate that the general knowledge and awareness of finance options available to SMEs in Kenya was poor, which hindered entrepreneur’s ability to access finance.

The issues and problems limiting SMEs acquisition of financial services can be grouped into two broad categories: lack of tangible security coupled with an inappropriate legal and regulatory framework that does not recognize innovative strategies for lending to the sector; and the limited access to formal finance due to poor and insufficient capacity to deliver financial services to many SMEs.

It is important to distinguish between an entrepreneurial venture and a small business, since it is entrepreneurship which fosters innovation and growth, and which should be the focus of government support. Growth is stimulated endogenously, through innovation, while employment is a natural consequence of a larger number of small businesses as well as the expansion of small businesses into larger enterprises (Namusonge, 2010).

Thus, policy formulation should focus on supporting and fostering an entrepreneurial mindset, which will contribute to innovation and create businesses that will have a greater probability of survival, with employment becoming a positive consequence rather than a direct goal. Entrepreneurial finance is seen as particularly important to this process as a form of long-term investment for start-up businesses (Migiro, 2006).

Along with this, it is important to remember that the small entrepreneur holds the key to rapid technological development and full employment (GoK, 1999).
entrepreneur offers a means whereby new employment opportunities can be created in rural areas. The small entrepreneur would not only provide a livelihood but would create employment for others, thereby easing up social tensions growing in an atmosphere where so many are deprived, such as is to be found in the underprivileged areas of the developing world.

1.2 Statement of the Problem

SMEs hold the key to rapid technological development and full employment (GoK, 1999). In the developing world, most jobs are reported to be created by SMEs (IDRC, 1999). The SME entrepreneur offers a means whereby new employment opportunities can be created (GoK, 1999). It is therefore necessary to aim at eliminating the many constraints facing these small businesses, such as limited choice of source of credit (IDRC, 1999).

In the developing world, most jobs, including those in the informal sector, were reported to be created by SMEs. It is therefore necessary to eliminate, as far as possible, the many constraints facing these small businesses, such as limited choice of source of credit (International Development Research Corporation [IDRC], 1999). Sourcing finance is one of the key problems hindering entry and growth of SMEs in that the type and the source of finance influences the success or acquisition of competitive advantage of an SME. SMEs that have accessed and applied entrepreneurial finance have performed better than those that have not. Namusonge (1999) observes that availability of finance influences the entrepreneurs’ choice of source. Many entrepreneurs borrow from commercial banks because they are the most obvious and accessible source of entrepreneurial finance. Other institutions
will also give information on the available sources for the entrepreneurs to decide where to borrow or not.

Entrepreneurial finance is seen as particularly important as a form of investment for start-up businesses (Migiro, 2006). In the developing world, Kenya included more than 90% of new ventures are financed by informal sources of finance (Pretorius, 2007). Further, more than 60% of the start-up capital is financed by the business founders (Pretorius, 2007). SMEs do not have adequate credit to meet the needs at different levels of growth (Njoroge, 2003).

Despite unequivocal evidence that more than 90% of new ventures are financed by informal sources of finance, and that more than 60% of the start-up capital is financed by the business founders (Pretorius, 2007), it is interesting to note that the vast majority of studies focus on the supply of formal sources of finance, mainly in the area of equity finance and debt finance. Of the small number of studies into informal source of finance, there is a focus on sources of finance from the entrepreneurs' family and social networks and financial bootstrapping in the process of entrepreneurship (Pretorius, 2007).

Owing to the problems associated with accessing alternative credit facilities, a large proportion of Kenyan SMEs rely more on self-financing in terms of retained earnings (for example see Ngigi, 1997; Njoroge, 2003; Onsomu, 2003). The implication, therefore, is that SMEs do not have adequate credit to meet the needs at different levels of growth. Njoroge (2003) has conducted a study on venture capital financing for SMEs in info-tech.
While most studies have focused on supply of formal sources of finance, mainly equity & debt finance; few studies have focused on sources revolving around family and social networks (Pretorius, 2007). None of these touch on the factors influencing choice of sources of entrepreneurial finance. This study aimed to fill the gap in knowledge on the factors influencing choice of sources of entrepreneurial finance for SMEs.

1.3 Research Objectives

1.3.1 General Objective

The general objective was to assess entrepreneur’s choice of source of entrepreneurial finance for small and medium-sized enterprises in Thika district

1.3.2 Specific Objectives

The following were the specific objectives of the study:

a. To determine the effect of firm size on the choice of source of entrepreneurial finance;

b. To investigate the effect of information availability on the choice of source of entrepreneurial finance;

c. To find out the effect of purpose of finance on the choice of source of entrepreneurial finance;

d. To evaluate the effect of cost of the source of finance on the choice of source of entrepreneurial finance;

e. To investigate the effect of entrepreneurs personal characteristics on the choice of source of entrepreneurial finance;
1.4 Research Questions

The research questions used in this study were as follows:

a. What is the effect of firm’s size on the choice of source of entrepreneurial finance?

b. What is the influence of information availability on the choice of source of entrepreneurial finance?

c. What is the effect of purpose of finance on SMEs on the choice of source of entrepreneurial finance?

d. Does the cost of finance influence the choice of source of entrepreneurial finance?

e. What is the effect of the entrepreneur’s personal characteristics on the choice of source of entrepreneurial finance?

1.5 Hypotheses

The study was guided by following null hypotheses:

1 Firm Size

H₀₁: Firm Size does not affect the choice of source of entrepreneurial finance

2 Information Availability

H₀₂: Availability of information does not affect the choice of source of entrepreneurial finance.
3  Purpose

\( H_{05} \): Purpose of finance does not influence the choice of source of entrepreneurial finance

4  Cost

\( H_{04} \): Cost of the source of finance does not influence the choice of source of entrepreneurial finance

5  Personal Characteristics

\( H_{05} \): Entrepreneurs personal characteristics as identified by gender, business status, religion and level of education, do not affect the choice of source of entrepreneurial financing

1.6  Importance of the Study

This section reviews the importance of the study to policymakers, providers of entrepreneurial finance, entrepreneurs, researchers and the local community.

1.6.1  Policymakers

The importance of entrepreneurial finance is demonstrated by the distinction drawn between small firms and entrepreneurial firms. Although both typically start out small, firms such as boutiques, have the intention of remaining small. Alternatively, “entrepreneurial” firms, such as supermarkets, are firms that start out small but have rapid growth as an objective.

These two types of firms face the problem of choice of source of entrepreneurial finance. In contrast, the capital requirements for an entrepreneurial firm are often
voracious. In the early years of the firm, cash outflows dramatically exceed cash inflows, and large amounts of external capital are required.

Entrepreneurial finance is that which provides a ready source of such growth capital. Entrepreneurial ventures are one of the main contributors to the creation of new jobs and the formation of new firms and given their importance to economic development of nations, it is then important to gain an understanding of the sources of entrepreneurial finance and the type of financial challenges that these offer. This information would be important in streamlining the sector and facilitating growth.

Again, entrepreneurial firms play a role in the economy as engines for growth, contributing to expanding the size of production in the economy, and generating tax revenue for the Government. Subsequently, Government planners will want to create an enabling environment for these firms to be able to raise capital to finance their activities and grow over time and continue providing employment.

A study such as this one will assist Government planners in understanding how to come up with policies that will help the entrepreneurial sector in raising and accessing affordable capital as this will have a great impact on the country’s economic growth.

1.6.2 Providers of Entrepreneurial Finance

Financiers will benefit from the findings of this study by developing a better understanding of the factors that influence entrepreneur’s through choice of sources of financing. These will enable them to develop product offerings that tries to circumvent any limitations and that which tends to increase choice for potential entrepreneurs.
1.6.3 Entrepreneurs

When properly harnessed, entrepreneurial finance offers a variety of benefits to the investors; Foremost, entrepreneurial financing initiatives can effectively address material poverty, the physical deprivation of goods, services, and the income to attain them. When properly guided, the material benefits of entrepreneurial finance can extend beyond the household into the community. At the personal level, entrepreneurial finance can effectively address issues associated with non-material poverty, which includes social and psychological effects that prevent people from realizing their potential.

1.6.4 Business and Academic Researchers

Knowledge about financing decisions has mostly been derived from data obtained from developed economies that have many institutional similarities. This study is of significance because it is being carried out from the perspective of the Kenya, a developing economy. Thus, the study findings might arouse the interest of business and academic researchers to carry out more studies in the context of developing countries especially in Africa. This study will contribute to researches in these areas.

1.6.5 The Local Community

The local community will be comprised of many youth who may be potential entrepreneurs. For these high potential grouping, the study will provide insight into the potential pitfalls as they venture towards creating employment opportunities for themselves.
The same applies to all other categories of new entrepreneurs, especially those who belong to economically vulnerable groups, such as women and the old. The local community will also benefit through being able to understand better the challenges those businesses serving them face and be more responsive in meeting their obligations to these SMEs.

1.7 Scope of the Study

This study examined determinants of sources of entrepreneurial finance of SMEs in various industries in Thika District. Thika has been selected as it is an industrial town and its proximity to proper infrastructure like that of Kenya capital, Nairobi, is highly conducive to economic growth in Central Kenya. The study attempted to examine for cross-industrial similarities or differences among the SMEs in relation to the determinants of sources of entrepreneurial financing.

1.8 Limitations of the Study

The study made certain methodological assumptions that arose from the kind of limitations characterized by restrictions imposed by the survey method. The methodology relied on standardization forcing the researcher to develop questions general enough to be minimally appropriate for all respondents, possibly missing what was most appropriate to many respondents. Also, surveys are inflexible in that they require the initial study design (the tool and administration of the tool) to remain unchanged throughout the data collection.

Again, the researcher had to ensure that a large number of the selected sample replied; it was hard for participants to recall information or to tell the truth about a controversial question; as opposed to direct observation, survey research (excluding some interview approaches) can seldom deal with ‘context’, which may have arisen
owing to different management styles adopted by the entrepreneurs or their different business pursuits.

This study deployed a cross-sectional survey design (interviewed respondents at one point in time) and these kinds of surveys are highly fallible because the researcher may or may not be able to analyze the direction of causal relationships. Sampling errors and biases were induced by the sample design as in the case of gender in this study.

The sample proportions with regard to gender differed statistically from the population proportions, implying a need to exercise care in making generalizations especially those that may have gender as a moderating variable. Other sampling limitations included selection bias, when the true selection probabilities differed from those assumed in calculating the results.

Random sampling error is said to exist where there is random variation in the results due to the elements in the sample being selected at random. Non-sampling errors are caused by other problems in data collection and processing. They included under-coverage, where sampling frame may not include critical elements in the population; measurement error e.g. when respondents misunderstood a question, or found it difficult to answer; processing error-mistakes in data coding and non-response or failure to obtain complete data from all selected individuals.

Item non-response or the submission or participation in the survey accompanied by failure to complete one or more components/questions of the survey was endemic. Some of the individuals identified as part of the sample may have been unwilling to participate, or may not have had the time to participate (opportunity cost), or survey
administrators were not be able to contact them. In this case, there was a risk of differences, between respondents and non-respondents, leading to biased estimates of population parameters.

Micro- and macro-economic context was assumed to remain constant or not to change so significantly as to invalidate the research objectives. At the entrepreneur level, not all the personal factors that may influence choice of source of financing were considered. These may include peer pressure, custom, experience with different financing strategies and so on.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter presents the following: a theoretical and empirical review underlying the study, conceptual framework that illustrates the relationship between the independent variables of size of the firm, the availability of information, the purpose of finance and the cost of finance on the dependent variables of choice of sources of entrepreneurial finance along with the moderating variables that influence this relationship. The study then proceeds to present the sources of entrepreneurial finance, a critique of the literature, the research gaps and, finally, the summary.

2.2 Theoretical Framework

2.2.1 Introduction

In this section a critical review of the theories on entrepreneurship is undertaken leading to the selection of the appropriate theoretical framework to adopt in the study based on some of the authors on entrepreneurship including Dollinger (2008), Desai (2009) and Saleemi (2009). A critique of the chosen theoretical framework used in the study is then presented and then linked to the conceptual framework.

2.2.2 Classical theories of entrepreneurship

a) Psychological/Trait theory

According to the psychological/trait theory, entrepreneurship gets a boost when society has sufficient supply of individuals with necessary psychological
characteristics. The psychological characteristics include need for high achievement, a vision or foresight and ability to face opposition. These characteristics are formed during the individual’s upbringing which stress on standards of excellence, self reliance and low father dominance but could also be imparted through training.

Dollinger (2008) views the main shortcoming of the trait theory as looking for similarity amongst the entrepreneurs. He argues that if all entrepreneurs had certain similar characteristics or traits, it is not an advantage to any of them. Hence other factors must account for the entrepreneurial behaviour and there must be differentiation in them if competitive advantage is to be acquired. Hence the pursuit should be one of the theory of differences, not commonalities.

Kruger (2004) observes that theories which place weight on personality are difficult to test. No single characteristic or set of characteristics studied so far seem to uniquely and conclusively explain entrepreneurial characteristics. Therefore it seems more appropriate to accept a continuum along which several types of entrepreneurs exist.

Drucker (2007), disputes that personality trait significantly accounts for the supply of entrepreneurship and avers that the foundation of entrepreneurship lies in concept and theory rather than in intuition and as a practice which has a knowledge base it can be taught. Hence entrepreneurial behaviour, rather than personality trait, is more important to enhance entrepreneurship.

b) Sociological theory
The sociological theory avers that entrepreneurship is likely to get a boost in a particular social culture. Social sanctions, cultural values, and role expectations are
responsible for the emergence of entrepreneurship. Society’s values are the most important determinant of the attitudes and role expectations. Individuals are culturally influenced in the perception of opportunity and in turn react differently to that which may or may not, according to prevailing cultural values, be considered to be an opportunity for entrepreneurship behavior.

The main criticism of the sociological theory is that it lays emphasis on the individuals social background and little emphasis on the individuals drive. Desai (2009) observes that based on this theory an entrepreneurship model which may be successful in one culture may not be expected to succeed in another and thus hampering theory development.

Drucker (2007) argues that the foundation of entrepreneurship lies in concept and theory. This implies that entrepreneurship can be taught to people of different backgrounds and thus break the barriers imposed by culture. Burnett (2000) argues that the supply of entrepreneurship is dependent on both individual level factors and general economic factors and not sociological background or traits as standalone factors. He further argues that not just anyone can be an entrepreneur but, agreeing with Drucker (2007) and McClelland avers that the skills of an entrepreneur can be taught. Thus, policymakers can affect the level of entrepreneurship in their countries by crafting policies that reform the market in order to encourage entrepreneurship both economically and educationally.

c) Economic theory

In economic theory, entrepreneurship and economic growth take place when the economic conditions are favourable. The firm is seen as an input combiner and
organizer. largely dependent upon the economic policy, programmes and economic environment of that country. The theory assumes that inputs are homogenous and can be purchased by all at a given price.

This theory has been criticized by observing that although economists have posed many theoretical interpretations of entrepreneurship, there has been very little empirical research conducted on this phenomenon (Burnett, 2000). According to Montaye (2006), the theory fails to explain entrepreneurship empirically because of the extreme simplifying assumptions in neoclassical economics, in particular perfect competition and static market equilibrium, which assume, in turn, free and perfect information about markets, production processes, and so forth. These assumptions, which reduce the economic process to clocklike mechanics, overlook the need for specialized individuals (entrepreneurs) to perform the discovery, coordination, promotion, and risk-bearing functions that neoclassical economics takes for granted.

Burnett (2000) observes that since few economists can even agree about how to define entrepreneurship, developing the tools to measure it has been especially problematic. Thus, observes Burnett, entrepreneurship arises to make up for a market deficiency, but the majority of mainstream economic models, assume perfect information and clearly defined production functions. Thus, entrepreneurs typically fall outside of these models.

Dollinger (2008) argues that economic theory assumes that the firm is an input combiner and organizer seen to lean on homogenous inputs that can be purchased by all firms at a given price but this is not the reality. In agreement with Dollinger (2008), Drucker (2007) avers that entrepreneurship is about systematic innovation and strategy that result in resources that are not commonly available in the market
and in most cases are only unique to a particular firm. Even imitation, according to Drucker (2007), results in different resources that gives the entrepreneurial firm a competitive advantage.

d) Schumpeterian innovation theory

Desai (2009) observes that a dynamic theory of entrepreneurship was first advocated by Joseph Schumpeter in 1949. According to Schumpeter, entrepreneurship is the catalyst that disrupts the stationary circular flow of the economy and thereby initiates and sustains the process of development. Innovation occurs when the entrepreneur introduces a new product into the market, introduces a new production method, opens up a new market, finds out a new source of raw material supply or introduces new organisation in any industry. Innovation is seen as the source of the entrepreneurial rewards with profit as the key indicator. According to Schumpeter, innovation was substantially driven by intuition, the capacity of seeing the essential facts and discarding the unessential even though one can give no account of the principles by which this is done.

This theory has been criticized as mainly applicable to large scale businesses and seems to disregard creative imitation that adapts a product to a niche market in a better way than the original innovation as happens in many developing countries on products innovated in the developed countries, rather than innovate to meet the bulk of market deficiencies (Desai, 2009; Saleemi, 2009). Dollinger (2008), also argues that other forces, other than the entrepreneur as averred by Schumpeter, may present potential shocks to the circular flow and may result in the creative destruction of capital, making it available for redeployment.
Like Schumpeter, Drucker (2007) avers that innovation is the real hub of entrepreneurship but unlike Schumpeter his view is that it is not confined to large scale enterprises and economic institutions but may happen in large or small enterprises, in private or public organizations. Unlike Schumpeter, Drucker’s view is that entrepreneurship is the practice which has a knowledge base, the foundation of which lies in concept and theory rather than in intuition.

The neo-Austrian school challenged this theory by arguing that dis-equilibrium, rather than equilibrium, was the likely scenario for entrepreneurship. A typical entrepreneur, according to various economists of the Austrian school, is the arbitrageur, the person who discovers opportunity at low prices and sells the same items at high prices because of inter-temporal and inter-spatial demands, emphasizing that the entrepreneur is constantly alert to profitable exchange (arbitrage) opportunities and is the first to act when such opportunities appear. This emphasis complements many theories of entrepreneurship (Montaye, 2006). The Austrian school economist Ludwig von Mises argued that entrepreneurship centers on the role of uncertainty and the only source from which an entrepreneur's profits stem is his ability to anticipate better than other people the future demand of consumers. The entrepreneur is a speculator, a person eager to utilize their opinion about the future structure of the market, the market dis-equilibrium as distinct from equilibrium, for business operations promising a profit, the only instruction required is self-understood and does not need to be especially mentioned: “Seek profit”.

e) The Life Cycle Theory

According to the life cycle theory, as with individual products, entrepreneurial firms go through a life cycle. An entrepreneurial firm may be at the idea stage, the prototype stage, the rapid growth stage, or the maturity stage. A number of researchers have pointed out that different types of finances are appropriate for different stages of firm development (Berger and Udell, 1998). However one of the distinctions between entrepreneurial finance and corporate finance is that entrepreneurial finance comes in to impart competitive advantage rather than sustaining the enterprise in its business as usual processes.

It is normal that during the earliest stages of the company, funding typically comes from the entrepreneur’s personal financial resources and savings or from family and friends. This is because, at this stage, the firm often lacks a viable product, customers, or stable revenues. As the firm grows and begins to generate revenues, however, angels and venture capitalists may take an interest. When the firm achieves profitability and some measure of stability, bank loans may become an option (Amidu, 2007). Further, when the company has achieved significant revenues and growth, it may be a candidate for sale or for an initial public offering. Thus, potential sources of capital vary in accordance with the age and size of the company (Namusonge, 2010).

Unlike large, mature companies, however, entrepreneurial firms do not consistently have a full range of debt and equity alternatives available to them. Over time, however, it becomes necessary to give away pieces of firm equity in order to raise capital from angels, venture capitalists, and eventually public shareholders. By the
time all is said and done, the entrepreneur may find himself owning a very small percentage of the company (Kolari, 1994). At that stage, however, it is a much larger company, so he is ultimately better off financially with a small slice of the much larger equity pie. As noted above, entrepreneurial firms are firms that start out small and grow rapidly, often explosively.

This type of growth puts tremendous strain on the management capabilities, organizational structure and finances of the firm. During its rapid growth stage, the firm consumes cash faster than it brings it in. This necessitates identifying and securing external sources of financing. Failure to do so in a timely fashion can result in slower growth or failure of the firm. In the formative stages, the inability to secure external sources of equity capital can lead to over-reliance on personally secured debt and cash shortages eventually resulting in a liquidity crisis. Problems with liquidity management are a major reason for firm failure (Coleman, 2007).

Whereas the life cycle theory links the choice and sources of finance to the stages in the life of an enterprise it fails to make distinctions between entrepreneurial finance and corporate finance. Further, it fails to show the significance of entrepreneurial finance coming in to impart competitive advantage rather than sustaining the enterprise in its business as usual processes.

2.2.3 Choice of Theoretical Framework for the Study

According to Dollinger (2008), a good theory is practical because it enables its user to be efficient. Efficiency for the entrepreneur means recognizing what information is helpful and knowing where it can be obtained and then use the theory to translate the raw information into usable data and process the data into categories and
variables and determine how these variables are related, causal relationships and the
direction of the relationships. In support of this view, Drucker (2007) avers that the
foundation of entrepreneurship lies in concept and theory rather than in intuition.

According to Alvarez (2005) the theory of entrepreneurship continues to struggle
with the development of a modern theory. This struggle has, however, centered on
either opportunity recognition or the individual entrepreneur or on economics where
the entrepreneur was at best viewed as the fourth factor of production. Observing
that there is lack of clarity about the theoretical assumptions that entrepreneurship
scholars use in their work, he points out that assumptions from both individual,
opportunity recognition and economics have been used as if they are
interchangeable. The failure to make theoretical distinction has constrained theory
development in entrepreneurship.

Although the propensity to entrepreneurship varies from one society to another, from
an individual to another, from one economic situation to another, a universal
constant is that no matter how many entrepreneurs emerge, most do not succeed in
creating lasting organizations and the list of potential pitfalls associated with starting
a new venture appears limitless (Aldrich & Martinez, 2001).

Aldrich and Martinez (2001) further argued that understanding how and why some
entrepreneurs succeed remains a major challenge for the entrepreneurship research
community. They noted that as intellectually stimulating as it may be to find out
what motivates entrepreneurs, the more crucial issue is how these individuals
manage to create and sustain successful organizations, despite severe obstacles.
Furthermore, they highlighted that any theoretical model should integrate the
outcomes of entrepreneurial efforts and the processes that led to those outcomes. In
addition understanding entrepreneurial success consideration of the social context in which entrepreneurs develop their efforts.

Alvarez (2005) agrees with Aldrich and Martinez (2001), arguing that while explanations of entrepreneurship have adopted different theoretical assumptions, most of these concern the nature of entrepreneurial opportunities, the nature of entrepreneurs as individuals, and the nature of the decision making context within which entrepreneurs operate. Nonetheless, various theoretical traditions in the field have adopted radically different interpretations with respect to these assumptions of entrepreneurial phenomena, therefore arriving at different explanations of these phenomena.

Alvarez (2005) suggested that the nature of entrepreneurs and the nature of the decision making context within which entrepreneurs operate are two sets of assumptions upon which logically consistent theories of entrepreneurship may be constituted. Moreover, these two sets are complementary and can be applied to widely studied entrepreneurial phenomena but none of them alone can comprehensively study the two facets.

Murphy (2011) argues that a conceptual foundation leads to classes of theories thus agreeing with Alvarez (2005) and Drucker (2007). He observes that currently most entrepreneurship theory relies on conceptual foundations from a mix of other areas, which does not promote a consistent literature that builds on itself. Whereas a wider array of theoretic streams offers a rich outlook on entrepreneurial discovery, a stronger conceptual foundation would promote relatable narratives and implications and help fulfill the area's need for a more integrated framework.
Burnett (2000) argued that a generalized set of entrepreneurship qualities can be developed. In this regard Aldrich and Martinez (2001) identified three elements indispensable to an understanding of entrepreneurial success: process, context, and outcomes. The critique by Aldrich and Martinez (2001) catapulted three important advances that include (a) a shift in theoretical emphasis from the characteristics of entrepreneurs as individuals to the consequences of their actions, (b) a deeper understanding of how entrepreneurs use knowledge, networks, and resources to construct firms, and (c) a more sophisticated taxonomy of environmental forces at different levels of analysis that affect entrepreneurship. From an evolutionary approach, process and context (strategy and environment) interact in a recursive continuous process, driving the fate of entrepreneurial efforts. Thus, integrating context and process into research designs remains a major challenge. Such integration constitutes a necessary step to a more complete evolutionary approach and a better understanding of entrepreneurial success.

By insisting on the inclusion of context, process, and outcomes in theoretical models and research designs, Aldrich and Martinez (2001) argued for the need for an evolutionary approach. Evolutionary theory unites in a single coherent framework a concern for entrepreneurial outcomes and the processes and contexts making them possible, using the basic concepts of variation, adaptation, selection, and retention. An evolutionary approach studies the creation of new organizational structures (variation), the way in which entrepreneurs modify their organizations and use resources to survive in changing environments (adaptation), the circumstances under which such organizational arrangements lead to success and survival (selection), and the way in which successful arrangements tend to be imitated and perpetuated by other entrepreneurs (retention).
Murphy (2011) therefore articulates a conceptual foundation for entrepreneurial discovery theory, with a shift from unidimensional to multidimensional logic. He argued that the shift promotes a more flexible and distinct conceptualization that extends the current dominant view and increases coordination of entrepreneurial discovery research across disparate theoretic streams. In this regard Murphy observed that the resource based theory (RBT) also extensively referred to as the resource based view (RBV) articulated by Barney (1991) is an evolutionary multidimensional theory in that it views entrepreneurship in terms of individual, the environment and constraints in it, as well as the organization responsible for the entrepreneurial processes and the outcomes of the processes. In other words RBT consolidates into one theory the context, processes and outcomes of entrepreneurship. This theory is reviewed below and its suitability for use in the study critically examined.

On the basis of the above review the economic, sociological and trait theories as well as the Schumpeterian innovation theory were considered largely inadequate to study the determinants of choice of entrepreneurial finance.

The key criticisms against the economic theory is that it makes unrealistic assumptions about the market and flow of information assuming perfect competition, market equilibrium and perfect flow of information within the market (Montaye, 2006; Burnett, 2000, Dollinger, 2008). It also completely ignores the entrepreneur who is responsible for the discovery of opportunities, creativity to solve customer problems and risk bearing (Montaye, 2006).

The sociological theory and the trait theories are criticized as being uni-dimensional, focusing only on the person of the entrepreneur, and failing to capture the full
context in which entrepreneurship thrives, the processes and outcomes (Alvarez, 2005). As Aldrich and Martinez (2001) pointed out, as intellectually stimulating as it may be to find out what motivates entrepreneurs and how they differ from ordinary mortals, the more critical question is how these individuals manage to create and sustain successful organizations.

Dollinger (2008) criticized the trait theory for looking for commonalities amongst entrepreneurs rather than differences for in that case none of the entrepreneurs would have any advantage over another. Instead, avers Dollinger (2008), we should be looking for a theory of differences not commonalities. The sociological theory has also been criticized on the basis that by taking the sociological background of the entrepreneur to be the main driver of entrepreneurial behavior, no theory can be developed for universal application in all cultures (Desai, 2009; Saleemi, 2009).

The Schumpeterian innovation theory has been criticized on the basis that it is largely applicable to large firms and ignores creative imitation which has been found to be responsive to satisfy specific customer requirements in niche markets (Drucker, 2007). The Austrian school also criticized this theory on the basis that the entrepreneurial driver is profiteering on the basis of speculation and not intuition (Desai, 2009). Drucker (2007) also criticized the theory on the basis that entrepreneurship lies in concept and theory, not intuition.

Whereas the life cycle theory links the choice and sources of finance to the stages in the life of an enterprise it fails to make distinctions between entrepreneurial finance and corporate finance. Further, it fails to show the significance of entrepreneurial finance coming in to impart competitive advantage rather than sustaining the enterprise in its business as usual processes.
On the other hand the resource based theory has been assessed as a robust and rigorous line of inquiry that captures entrepreneurship in its multidimensional perspectives- context, processes and outcomes (Murphy, 2011, Jaquier, 2010; Mills, 2010).

On the basis of this review, the economic, sociological and trait theories, the Schumpeterian innovation theory and the life cycle theory were considered largely inadequate to study the determinants of the choice of source of entrepreneurial finance and the focus was directed to a multi-dimensional theory of entrepreneurship. The resource based theory, being a multi-dimensional theory that integrates context, processes and outcomes of entrepreneurship in one theory was chosen as the theoretical framework for the study and is given further articulation in the following sections.

2.2.4 Resource Based View (RBV)

Economic theory holds that in the normal course, and in the absence of market imperfections, abnormal economic rents will get competed away by rivals or new entrants to an industry (Executive Fast Track, 2011). This is in agreement with observation by Powell (2007), that in the market based view (MBV), firms are seen as being homogenous and competition is seen as occurring via positioning in the markets- the strategic challenge for the firm being the identification of attractive markets to compete in. Powell avers that the question not asked in the MBV is whether the market opportunity is one that can be exploited by the firm or not, that is, does the firm have the resources and competencies to compete in the market?

Powell (2007) observed that the capability of a firm to compete in the market may be viewed on the basis of its resources and competencies; that is a resource based
Barney articulated that RBV emphasizes strategic choice identifying, developing and deploying key resources to maximize returns. Each organization is a collection of unique resources and capabilities that provides the basis for its strategy and the primary source of its returns. Barney postulated that the competitive advantage or sustained competitive advantage of a firm could be determined on the basis of whether the resources/resource mix the firm possessed or could acquire had the attributes valuable, rare, inimitable and non-substitutable applied under a strategy that maximized strengths of the firm, optimally utilized the opportunities and mitigated against threats and weaknesses taking into account the internal and external environments.

The main criticism raised against RBV is that it apparently reflects a unique feature, namely, that sustainable competitive advantage is achieved in an environment where competition does not exist. The critics argue that according to the characteristics of the RBV, rival firms may not perform at a level that could be identified as considerable competition for the incumbents of the market, since they do not possess the required resources to perform at a level that creates a threat and competition (Ethiraj, et al., 2005, Chatain, 2010). These critics argue that through entry barriers, barriers to imitation, incumbents ensure that rival firms do not reach a level at which they may perform in a similar manner to the former. In other words, the sustainability of the winning edge is determined by the strength of not letting other firms compete at the same level. The moment competition becomes active, competitive advantage becomes ineffective, since two or more firms begin to perform at a superior level, evading the possibility of single-firm dominance; hence, no firm will enjoy a competitive advantage. Further such sustainable competitive advantage could exist only in the world of no competitive imitation.
Mills (2010) observed that the achievement of any of business objectives is dependent on the firm’s strengths and weaknesses. Mills argued that RBV is the one approach that concentrates on the individuality of each firm, the important differences between each firm and its competitors. In support of this view, Kotelnikov (2010) articulates that RBV of firms is based on the concept of economic rent and the view of the company as a collection of resources and capabilities, pointing out the need for a fit between the internal resources and capabilities of the firm and the external environment in which a firm operates.

Kotelnikov (2010), arguing in support of RBV in a dynamic perspective, argues that a firm is a collection of evolving capabilities that is managed dynamically in pursuit of above-average returns. Differences in firm's performances over time are driven primarily by their unique resources and capabilities. Individual resources may not yield to a competitive advantage but it is through the synergistic combination and integration of sets of resources that competitive advantages are evolved. Jaquier (2010) asserts that the RBV provides a rigorous model for analysing the competitive advantage (CA) or sustained competitive advantage (SCA) of a firm, combining internal analysis with external analysis.

Murphy (2011) advocating multidimensional theoretical frameworks, agrees with Jaquier (2010) and specifically pinpoints that RBV is multidimensional in its representation of entrepreneurship and accounts for a robust line of inquiry that underlies a plurality of distinct streams in the area. Dollinger (2008) argues that the resource-based theory is efficient and practical because it focuses on the strengths, assets and capabilities of the entrepreneurs and their ventures. It incorporates market opportunity, industry conditions and competition but it also emphasizes resources,
skills and capabilities (including the skill and capability to learn new skills and capabilities) of the entrepreneurs and the organization.

Desai (2009) articulates a multidimensional conceptual model of entrepreneurship (Figure 2.1) with following dimensions; (1) individual entrepreneur, (2) environment – resources and constraints and; (3) organization.

Figure 2.3: Conceptual Model of Entrepreneurship
Source: Desai (2009)

**Researcher’s View on the RBT**

The criticism leveled against RBV seems to miss the point that competition is a struggle to create differentiation above the competitors or at the very least a struggle for survival by keeping abreast the rest of the competition. Falling behind on this, means taking exit sooner or later. Failure to create a differentiation means the enterprise will fall out as soon as its competitors create a differentiation. Creating and sustaining the threshold of the differentiation requires entrepreneurial behavior in dynamic creativity, not a once in lifetime innovation. In fact this differentiation is the purpose, the logical and realistic struggle and outcome of thriving
entrepreneurship and it will be there for as long as there will be entrepreneurial enterprises. What RBV postulates is therefore not inconsistent with entrepreneurship, but rather an affirmation of the entrepreneurial struggle, the motivation for the struggle being desired entrepreneurial outcome, that if a firm can attain sufficient threshold of this differentiation then it will have a competitive advantage and if it can sustain this differentiation it will have sustained competitive advantage. The behavior of the entrepreneurial enterprise to create this differentiation is what Drucker (2007) referred to as purposeful innovation, what Joseph Schumpeter referred to as creative destruction of capital and these are struggles to create a threshold differentiation above competitors; quite consistent with RBV.

In view of the presented analysis, this study adopted the resource based theory as the theoretical framework to study the factors influencing the choice of source of entrepreneurial finance. The theoretical and conceptual frameworks presented hereafter are derived from the conceptual model of entrepreneurship presented in Figure 2.1.

**SME’s in the Perspective of RBT**

When the conceptual model for entrepreneurship (Figure 2.1) is specifically applied to SME’s it translates to: (1) the individual SME entrepreneur; (2) the Organization (3) the environment; the prevailing policy, legal and regulatory frameworks. This conceptual model of entrepreneurship as applied to SME’s is presented in Figure 2.2.
Citing the earlier works of Barney (1991), Jaquier (2010) articulates a framework for analysis of the CA or SCA of the firm based on RBT. Resource-based analysis of the firm determines which resources and capabilities result in which strengths or weaknesses, what constitutes strengths, weaknesses, opportunities, threats, strategies to be implemented (those that build strengths to exploit opportunities and avoid or mitigate weaknesses). The analysis then determines resources/capabilities with the four attributes valuable, rare, imperfectly imitable and the favorable/unfavorable industry conditions. The CA or SCA of the firm (sustainability) is then predicted on the basis of RBT. Under RBT framework of analysis the determinants of choice of source of entrepreneurial financial resource with the four CA attributes valuable, rare difficult to imitate non- substitutable may be assessed. SMES are faced with difficult challenge of obtaining finances that would give them a competitive advantage. This kind of finance referred to as entrepreneurial finance must enable the firm to grow, reduce cost of operations and increase sales volume by offering attractive pricing of products and services.

Figure 2.4: Conceptual Model of Entrepreneurship Applied to SMEs
Source: Based on Desai (2009)
2.3 Conceptual Framework

As explained in the choice of theoretical framework, RBT was used to study the determinants of choice of source of entrepreneurial finance taking into account the internal and external environments. The conceptual framework (Figure 2.4) presents the postulated factors (the independent variables) and the dependent variable (choice of source of entrepreneurial finance) and illustrates the expected relationship between the independent variables and the dependent variable. It also provides the initial framework for analysis on the basis of the expected relationship between these variables. Using the measurements of the independent variables (the postulated determinants) choice of source of entrepreneurial is predicted on the basis of the RBT.

In the conceptual framework the dependent variable – choice of source of
entrepreneurial finance and the pertinent independent variables expected to influence the choice of source of Entrepreneurial of SMEs were identified within the context of resources based theoretical framework. This was done taking into account the internal and external contexts of the SMEs.

Figure 2.4: Conceptual Framework

2.4 Review of Determinants of Choice of Source of Entrepreneurial Financing

This study identified four determinants of source and choice of source of entrepreneurial financing believed to be key to entrepreneurial firm’s ability to access financing. These were the firm size, information availability, purpose of finance, and cost of finance.
2.4.1 Size of the Firm

There are several theoretical reasons why firm size should be related to sources of entrepreneurial finance. Smaller firms may find it relatively more costly to resolve informational asymmetries with lenders and financiers, which discourages the use of outside financing and should increase the preference of smaller firms for informal relative to formal finance. However, this problem may be mitigated with the use of short-term debt (Cosh and Hughes, 1994).

The literature includes some contradicting evidence on the relationship between firm's size and its financing strategies. On the positive side, Homaifar et al. (1994) conclude that large firms had more long-term debt and small firms had more short-term debt. Ozkan (1996) reports that smaller firms tend to have lower debt levels. Similarly, Ghosh et al. (2000) report a significant positive relationship between assets size and long-term debt ratio.

Rajan and Zingales (1995) present an alternative argument for size that suggests that informational asymmetries between insiders in firms and the capital markets are lower for large firms. Accordingly, large firms should be more capable of issuing informationally sensitive securities like equity and should have lower debt levels. However, in all four countries studied by Rajan and Zingales, net equity issuance by firms in the largest size quartile is significantly less than for firms in the smallest size quartile.

For entrepreneurial firms, Harrison et al. (2004) concluded that the size of the business as defined by the number of permanent employees, made a significant difference in how the business perceived the importance of bootstrap financing.
techniques applied. However, size, as defined by the number of employees was found by Gregory et al. (2005) as having significant correlations with ability to access certain sources of financing associated with bootstrapping strategies.

They suggested that smaller businesses place a greater importance on the application of bootstrapping techniques than larger businesses. Gregory et al. (2005) concluded that size, as dictated by the volume of annual sales generated, may not explain the ability to access finances, since both small and large businesses have different growth intentions and thus different capital requirements.

Pretorius (2007) conducted a study on bootstrapping financing as applied by South African entrepreneurs. In relation to size as defined by the number of employees, this study found a significant difference with regard to the importance of selected bootstrapping techniques, partially supporting the findings of Harrison et al. (2004) and Gregory et al. (2005). More significant was that in Pretorius’ (2007) study, these techniques were perceived to be more important for the smaller businesses than for the larger businesses.

For size as dictated by volumes of annual sales generated, Pretorius (2007) findings supported those of Gregory et al. (2005) that these measure of firm size did not significantly explain the choice of selected sources of entrepreneurial finance as elaborated by given bootstrapping techniques.

In all these instances, these studies generated findings that only partially correlated with each other owing to methodological differences in the research designs. An example of these was the definition of SMEs based on the number of employee
where Gregory et al. (2005) used large to stand for 500 employees and above while Pretorius (2007) used a narrower categorization scope.

In many developing countries, entrepreneurs have limited access to formal credit. In sub-Saharan Africa, for example, the banking-sector penetration is roughly 10% of the population (Berenbach and Guzman, 1994). In Kenya, there are about 2.2 million micro-, small- and medium-sized enterprises (Strategic Business Advisors [Africa] Ltd, 2007), of which 88% are non-registered.

Of this non-registered group, only 23% have bank accounts, and only 10% have ever received credit from any formal source. Atieno (1998) has observed in a survey done in Kenya that about 70% of the respondents got their initial capital from family, friends and relatives while 81% got their operating capital from the same financier.

Access to capital is thus an on-going problem in the case of entrepreneurial firms (Bates and Nucci, 1989). Retained earnings are a major source of financing for mature, established firms. In some industries, in fact, it is the major source of financing. In contrast, entrepreneurial firms spend a tremendous amount of time hustling for sources of capital.

Since entrepreneurial firms are rapid growth firms, their capital requirements typically outpace their ability to generate cash. Further, many entrepreneurial firms are unprofitable, particularly during their early years, and others do not generate sufficient profits to fund their own needs.

Ngehnevu and Nembo (2010) observe that new businesses have problems in getting a favorable position in the market. Their existence is determined by their size and
As going concerns, it means they are capable of maintaining their size and even expanding.

This makes the firm to gain legitimacy and thus be trusted as a successful business since it emits positive signals. Firms that are young and small face difficulty in acquiring resources for the proper functioning of business activities and they are always associated with external organizations in a vertical manner for support.

The integration of the young firm with a well-established one offers access to resources such as funding. Businesses employing this approach to gain creditworthiness are at risk since they are not independent although they may benefit from lower transaction costs due to increased economies of scale (Ngehnevu and Nembo, 2010).

Given the small scale of entrepreneurial projects and a higher information asymmetry and higher risk, financial institutions find it costly to monitor small businesses, even if advances in technology (including the risk scoring techniques) imply that the banking sector is capable of handling the entrepreneurial finance better than in the past.

The use of external equity, in particular institutional venture capital, is marginal in the prevailing majority of countries. According to Bygrave (2003), formal venture capital tends to play a more significant role only for a very limited number of firms; while in contrast, sources of informal financing are accessible by all entrepreneurial ventures, regardless of their observable growth and innovation prospects.

Ngehnevu and Nembo (2010) conducted an empirical study to assess the impact of Microfinance Institutions (MFIs) in the development of SMEs in Cameroon under
the auspices of the Cameroon Cooperative Credit Union League (CamCCUL). They found out that early stage businesses were not easily granted loans.

Most of them found it difficult to meet the requirements for servicing loans. The granting of loans was much easier for large compared to small firms. MFIs considered CamCCUL clients ability to repay debt and assess the minimal sum they could contribute as equity before offering a loan.

Existing firms were considered to have a history that could be quantitatively and qualitatively appraised by the MFIs before granting a loan. A bad history meant loan denial and a good history that the loan will be granted. A start up business does not have this history and MFIs do not rely on them because of the problem of information asymmetry. This is in confirmation with Garson (1998) that MFIs prefer to provide products and services to meet the needs of growing businesses since they are considered more reliable and less risky.

Venture capital investors have an advantage over angel investors in overcoming the information asymmetry and moral hazard problems because they have more information about the entrepreneur and firm. By the time VCs gets involved, the newly created firm has demonstrated the viability of the business and the use of previously obtained funds (possibly from angel investors). Angel investors have much less information about either the potential of the business innovation and/or the quality of the entrepreneur.

These fundamental problems are even greater at the initial start-up phase. Indeed, these problems may be so great at start-up that much of the institutional financing may not be in the opportunity set. Entrepreneurs may have to turn to informal
financing sources at initial start-up. Indeed, Vos et al. (2007) suggests that the entrepreneurs may prefer financing from these connected investors.

2.4.2 Availability of Financial Information

The higher the level of information asymmetry, the higher the perceived risk, the less the likelihood of adopting a particular source of finance. In scenarios where firms have to make a choice, then that ranges from low risk to high risk capital sources as dictated by the availability of information sources (Myers and Majluf, 1984).

As also seen earlier, the existence of information asymmetries between the firm and likely finance providers causes the relative costs of finance to vary between the different sources of finance (Fama and French, 2005). Due to asymmetries of information between insiders and outsiders, the company will prefer to be financed first by internal resources, then by debt and finally by stockholders’ equity, in this ‘pecking’ order.

Migiro (2006) conducted an empirical study relating Kenyan manufacturing SMEs’ finance needs to information on alternative sources of finance. The empirical evidence suggested that the majority of the SMEs operators in Kenya were not aware of certain sources of finance. Apart from a lack of knowledge on what they were, it was acknowledged by some respondents that it was difficult to obtain information on them.

The findings indicate that the general knowledge and awareness of finance options available to SMEs in Kenya was poor. This was due to a lack of understanding of
what is available due to fragmented financial information and a lack of targeted awareness and educational schemes with a view to raising the profile of finance issues among the SMEs. A failure to increase awareness of the finance options may result in the inappropriate usage of finance and misconceptions on finance availability for SMEs.

The empirical results indicate that there was an information gap in SMEs financing, that is, the necessary knowledge on finance sources was lacking. The respondents felt that they had difficulties knowing where to access business finance. They needed information and knowledge on alternative sources of finance applicable to their situation, be they freely available in the public domain or only accessible at a price.

There are numerous types of finance available to SMEs in Kenya. However, their details are very fragmented and it is very difficult to identify: What finance options are currently available; which option(s) is (are) most appropriate; the restrictions for an application; and how to apply these; this study will attempt to shed light on some of these aspects (Migiro, 2006).

Policies and strategies designed to boost credit and finance to the MSE sector have been formulated in the absence of reliable information on appropriate methodologies, data on the magnitude of the sector, characteristics of the sector operators and factors influencing the growth and dynamics of the sector (Green, Kimuyu. and Murinde, 2002). The situation translates into high credit transaction costs for collecting and verifying available information mainly on the creditworthiness of sector borrowers.
Namusonge (2004) conducted a study whose intention was to investigate how three selected development financial institutions (DFIs) in Kenya have helped or hindered the acquisition of technological capabilities in SMEs. The rationale for selecting these institutions was that DFIs have important but underutilized capabilities for providing credit and consultancy services for technological development.

In dealing with entrepreneurial firms, providers of capital try to circumvent the problem of asymmetric information in a variety of ways. Venture capitalists often place one of their own people on the management team or Board of Directors for firms that they fund (Kolari, 1994). They also establish specific performance benchmarks and dole out successive rounds of financing only when designated targets have been achieved.

Again, establishing on-going banking relationships is another way to deal with the problem of asymmetric information. In a study of small firms, Petersen and Rajan (1994) found that firms that concentrated their borrowing among a smaller number of banks benefited from lower interest rates and greater availability of financing.

Similarly, Berger and Udell (1998) found that longer banking relationships led to lower interest rates on loans. Further, banks were less likely to require collateral from firms with whom they had longer term relationships. These relationships provide lenders with the opportunity to learn about privately held firms and to gain a better understanding of their prospects for growth and profitability.

The study identified local company support, private sector support, funds from levies contributions by research beneficiaries, contract mechanisms, foreign direct investment (FDI), joint ventures, licensing franchising, management contracts,
marketing contracts, turnkey contracts, technical service contracts and international sub-contracting as alternative sources of project financing.

The study concluded that DFIs and Government should increase funding for SME financing cycles covering idea generation, feasibility study, project design and project implementation. These programs were proposed in order to increase the success rate of SMEs that are funded.

2.4.3 Purpose of Entrepreneurial Finance

The business activity of a venture is equally as important as the level of business development. Generally, in Africa, there are three main primary sectors where an enterprise may be classified, these being, production, agriculture and services (Ngehnevu and Nembo, 2010). Each of these sectors has its own risk and financing needs that are sector specific.

Financiers are motivated to finance a particular sector after analyzing the purpose for the loan, term of the loan, and the collateral on hand for each. Some financiers target only one sector while others provide products and services for more than one sector. Their actions are determined by their objectives and the impact they wish to achieve.

Higgins (2001) observes that the kind of long term financing that is provided to a particular company depends on its type. For example, the long term financing that is provided to a sole proprietorship is different from that provided to a partnership. This is because long term financing is used in different ways by different types of business entities. The business entities that are not corporations are only supposed to
use long term financing for the purposes of debt. However, the corporations can use long term financing for both debt and equity purposes.

Short-term financing opportunities are available in a variety of ways to firms in global business. The majority of short-term transactions covered by financing are for periods of 180 days or less (Higgins, 2001). Short-term financing requirements result from the need to increase inventory. Inventory is then converted to sales which, if extended payment terms are given, create accounts receivable.

Inventory and accounts receivable are short-term in nature and provide a collateral base for a lender to provide financing. A company may need financing when the inventory and accounts receivable grow at a fast pace as a result of continually increasing sales.

Then there is a greater need for funds to support the increase in the accounts that are growing at a faster rate than the accounts receivables can be converted to cash. The key factors in determining eligibility for short-term financing are whether the product is to be re-sold or used by the buyer. Financing is limited by the product's useful life and whether or not it is considered capital equipment or inventory (Amidu, 2007).

Capital equipment can usually be financed for periods greater than one year, whereas most manufactured goods and agricultural products cannot. There are always exceptions to this rule; for example, many governments promote the export of agricultural products by offering guarantees on medium-term financing.

The purpose of long term finance is to finance fixed assets; to finance the permanent part of working capital; the expansion of companies; increasing facilities;
construction projects on a big scale; provide capital for funding the operations. This helps in adjusting the cash flow. Factors determining long-term financial requirements include nature of business; nature of goods produced; and technology used (Pandey, 1999).

In the case of external financing, the company can basically either (1) sell shares; or (2) borrow finances from banks and/or other financial institutions (Langdon. and Bonham, 2004). There are other ways in which externally generated finance can be obtained, but these are the two principle methods, and the fundamental choice facing the owners of the business. When an investor buys a share, he/she pays over a sum of money that does not have to be given back by the business in return for a share in the ownership of the company.

Brown and Klapper (2008) describe how external financing is made difficult for entrepreneurs because of two fundamental problems; information asymmetry and the moral hazard problem. While the entrepreneur understands the quality of the proposed business, it may be difficult for investors to do so.

Alternatively, outside investors and the entrepreneur may disagree about the value. The moral hazard problem recognizes that once substantial external funding is achieved, the entrepreneur may have the incentive to misuse or misallocate those firms to benefit themselves.

Entrepreneurial ventures may be financed depending on their level of business development (MRM, 2008). Unstable survivors are firms that are not considered credit worthy for financial services to be provided in a sustainable way. Their enterprise is unstable and it is believed they will survive only for a limited time and
when MFIs focus on time to revert the situation by providing them other extra services, it is noticed that costs increases and time is also wasted.

Stable survivors are those who benefit in having access to entrepreneurial financial services to meet up with their production and consumption needs. These types of microenterprises rarely grow due to low profit margins which inhibit them from reinvesting and an unstable environment due to seasonal changes which makes them to consume rather than to invest in the business.

Growth enterprises are entrepreneurial firms with high possibility to grow. Financiers focusing on these types of firm are those that have as a primary objective, job creation and to move micro-entrepreneurs from an informal sector to a formal sector. Financiers prefer to provide products and services to meet the needs of this group since they are more reliable and pose them the least risk (MRM, 2008).

In the entrepreneurship literature, the importance of capital to new ventures is well accepted (Pandey, 1999). The probability of individuals becoming entrepreneurs is found to increase with their assets-size. As a determinant of firm formation, capital is important because it influences not only the ability of firms to enter into markets, but also their performance post-entry.

Empirical studies on new ventures have established that sufficiency and size of initial capital resources boost the ability of new firms to survive earn higher profits and grow. There may exist capital requirements that discourage entry of new firms, positioning financing requirements as a potential entry barrier. In a review of studies in the economics literature on the determinants of firm entry, Geroski (1995) arrived at a stylized result that capital-raising requirements are important barriers to entry.
Capital requirements act as entry barriers because entrepreneurs are usually liquidity constrained. The resources required to form a new firm are usually beyond the means of individual entrepreneurs. Entrepreneurs therefore look to external sources of financing to overcome the entry barrier of capital requirement.

### 2.4.4 Cost of Entrepreneurial Finance

The cost of capital is a term used in the field of financial investment to refer to the cost of a company's funds (both debt and equity), or, from an investor's point of view "the shareholder's required return on a portfolio of all the company's existing securities" (Cassar, 2004).

It is used to evaluate new projects of a company as it is the minimum return that investors expect for providing capital to the company, thus setting a benchmark that a new project has to meet. As such, in studying the financing options of start-ups, many factors other than the direct cost of funds may influence the financing decisions of both financier and entrepreneur.

Koch and Macdonald (2000) observe that bank loans and loans from financial institutions are injections of capital, but this capital does have to be paid back, and at interest. The company does not lose control of the direction of the business, but it must generate revenues and profits sufficient to pay off the loan and the interest.

If the interest rate is variable, the company could expose itself to changes in interest rates, with increasing costs and a resultant profit squeeze or loss. This is the basic choice facing the directors or owners of any company that seeks further finance. Generally, bank financing is more costly to the borrower than a public issue.
Internal sources are often preferable to a firm as they will usually be cheaper and perhaps easier to arrange at short notice (Koch and Macdonald, 2000). However, the potential for arranging large amounts of finance may be low. The main internal sources are profits and savings from reduced working capital.

Failure of the firm may lead to personal bankruptcy as well. Ang (1992) also noted that most small firm owners have undiversified personal portfolios; all of their assets and wealth are tied up in the firm. To make matters worse, the firm is typically their employer and may also employ other members of the family. If the firm fails, the entrepreneur, in addition to his friends and relatives, lose not only their wealth but their jobs as well. This lack of diversification adds to the riskiness of operating an entrepreneurial venture.

One of the major reasons why Kenyan lenders are reluctant to lend to start-up entrepreneurial ventures is that they lack cost-effective ways to quantify credit risk. There are currently no licensed credit bureaus with standardized data procedures, and SMEs financial statements, audited or not, may be of unreliable quality and veracity.

Lenders, whether formal or informal, have a financial duty to make prudent loans with their depositors’ and investors’ funds. Thus, most limit their risk with the SME market either by not lending at all or by charging high interest rates and requiring at least 100% collateral coverage (Steadman Group Research Division, 2007).

Many entrepreneurs are reluctant to seek credit. The vast majority of bank credit customers indicate that the costs of getting a loan are high, interest rates are very high, it is difficult to meet the requirements for getting a loan, and there is a
common perception that borrowing from a formal lender will imply losing assets and property (Steadman Group Research Division, 2007). One result of banks’ limited ability to assess risk is a reduction of access to appropriate and affordable credit and consequently, reduced prospects for the development of SMEs and national economic expansion.

Government regulation of entry is recognized as a barrier to entry. Regulatory and procedural requirements entail business costs to be incurred by entrepreneurs, in terms of financial outlay and/or time consumed. Prohibitive costs may deter potential entrepreneurs or drive them into the informal economy (Djankov et al., 2002), hampering their ability to grow and contribute to economic growth due to lack of proper access to social, legal and business infrastructures.

Four measures are used by the World Bank (2004) to capture various aspects of the registration process for new ventures in a country, measuring the cost of a starting a business. The four measures are: the number of procedures involved in the process, the number of days associated with the procedures, the official costs associated with the procedures and the minimum capital required before the registration process starts.

The number of procedures describes the number of external parties, usually government-related, that the entrepreneur faces before his new business is registered. For many less developed economies, a higher number of procedures present greater opportunities for bribes to change hands.

According to Microfinance Risk Management [MRM], (2008), supposing that banks overcome their reluctance to share positive information with credit bureaus,
predictive generic scores will probably become available within the next three years or so. This improvement in risk assessment will result in more efficient and standardized underwriting. It will also allow risk-based pricing, leading to lower costs of borrowing for the best customers and potentially greater credit availability for higher-risk customers.

From a review of previous research on the SME perspective in Nairobi, it was clear that effectively developed and managed credit scoring would help meet their needs in a variety of ways (MRM, 2008). For example, credit scoring can eventually: reduce reliance on collateral, as competition increases, lead to risk-based pricing, resulting in a lower cost of borrowing for the lowest-risk customers and potentially greater credit availability for higher-risk customers, who, without risk-based pricing, would simply be denied loans, additionally, turn-around times from application to approval and funding would likely decrease. And as lenders become more confident in scoring’s accuracy, risk-adjusted approval rates may go up.

For an investment to be worthwhile, the expected return on capital must be greater than the cost of capital (Pandey, 1999). The cost of capital is the rate of return that capital could be expected to earn in an alternative investment of equivalent risk. In line with developing the impact of financing cost on access to entrepreneurial finance, an unbiased estimate of returns to capital has important policy implications in several areas.

First, the returns from investment provide an upper bound of interest rates that borrowers are willing to pay to micro-lending organizations. Higher returns imply a higher likelihood of developing financially sustainable micro-lenders. There is
considerable debate about the sensitivity of microfinance demand to higher interest rates.

McKenzie and Woodruff (2008) observe that Mexico has a very underdeveloped micro-lending sector relative to other low- and middle income countries. High returns may suggest the scope for more lending. Second, if returns are below some investment threshold, these low returns may act as an entry barrier, preventing high-ability entrepreneurs without access to capital from entering.

If returns to capital are high at very low levels of investment, capital-constrained entrepreneurs should be able to enter and grow to a desired size by reinvesting profits earned in the enterprise. In this case, capital constraints will have short-term costs but fewer long-term effects on outcomes. High returns at low to very low capital stock levels suggest that credit constraints will not lead to poverty traps. The recent literature generally finds high rates of return to capital in small-scale enterprises.

With one exception, it uses non-experimental approaches to estimate the return to capital. Sulaiman (2003) use changes in laws forcing Indian banks to make preferential loans to certain groups of firms (considerably larger than those studied here) to identify changes in access to finance among the firms.

They conclude that returns to capital are 74-100% a year. Anand Kumar and Newport (2005) estimate annual returns to capital among small-scale agricultural producers on median-sized plots in Ghana at 50% for traditional crops and 250% for nontraditional crops. They also calculate the effective discount rates from the market for used taxi parts.
Using data on prices and useful lives of used taxi parts, they estimate the annual discount rate among taxi drivers to be 60%, suggesting that the shadow value of capital among taxi drivers is at least this high. Fowler and Kinyanjui (2004) creatively use the data on stock-outs and discounts for bulk purchases to estimate annual returns of at least 113% for rural retail shops in Kenya.

Formal financial institutions have failed to provide credit to the poor most of who are to be found in developing countries and to be more specific, in the rural areas. The reasons given by von Pischke (1996) are that their policies are not meant to favor the poor. The poor are mostly illiterate and banks lack skills to target these rural customers.

In these areas, the population density is very low resulting in a high transaction cost owing to the need to move for long distances and also that it takes time to meet the customers. SMEs in developing countries are considered to be too unstable by banks to invest in.

In Cameroon, Ngehnevu and Nembo (2010) observe that formal financial institutions are reluctant to lend to SMEs since investing in SMEs activities is considered risky. SMEs have low financial power, poor asset quality, and are unstable. The application process for a loan is long and it is difficult for SMEs to meet up with the demands and collateral requirements.

They cannot afford these collaterals which include estates, and other fixed assets valued usually at 200% of the loan. The major setback that prevents SMEs to get funding from external sources is the problem of information asymmetry or the
magnitude of the deviation of the correct information that is needed by the lending institution.

Banks use cash flows and profitability to measure or to assess the worthiness of a business. This is very expensive and is not a good method to measure the credit strength of rural SMEs. Production and distribution in the rural areas is influenced by social factors that are often neglected by enterprises in developing countries Rahman, A. (1999). Agriculture dominates rural activities in developing countries and is dependent on the weather conditions for its output. An enterprise in this sector is considered risky because its outcome is highly variable.

2.4.5 Effect of Personal Characteristics on Choice of Source of Entrepreneurial Finance

Choice of sources of financing is determined by both internal and external factors and it is important to acknowledge that financing decisions are context specific and is affected by the firm’s characteristics, its history, as well as the personal characteristics of the entrepreneur. An example of internal factors included the owner’s characteristics, such as goals and business objectives while an example of external factors included market conditions.

Muhanna (2007) identified the primary entrepreneurial factors influencing entrepreneurial development in South Africa as education, social network effects, as well as individual characteristics such as cognitive ability. Muhanna recognized that entrepreneurs were generally better educated than non-entrepreneurs and that entrepreneurs tended to come from entrepreneurial families or have friends who were themselves entrepreneurs.
Choice of sources of financing is influenced directly by the entrepreneur’s knowledge of the sources of capital available to the entrepreneur. Other personal factors may also contribute, for example, Li (2008), observes that entrepreneurs located in the Wuhan area of China are motivated by the need for personal achievement, the desire to make a direct contribution to the success of an enterprise, and the desire for family security. These factors will themselves have a direct impact on the entrepreneur’s ability and intention when accessing entrepreneurial resources.

The entrepreneur’s personal characteristics like wealth and experience may also impact the external financing opportunity set. For example, Avery et al. (1998) show that the commitment of a small business owner’s personal wealth is important for the firm obtaining external credit and loans. Cole et al. (2004), report that personal characteristics of small business owners are crucial determinants in getting loans from small banks.

Kaplan et al. (2009) also examine the role and dynamic evolution of alienable assets, business line, and human capital for start-up firms. They find alienable assets and business lines are critical and stable for the success of start-up firms long after acquiring external public financing.

Another unique characteristic of these firms is that the owners, i.e. the entrepreneurs, tend to highly value the private benefits of control. These control rents include the prestige and status that comes with ownership, the power to decide on the business strategy of the firm and independence from superiors (Mason and Harrison, 2002)). Given the inherent risk involved in start-up ventures, financing decisions are likely to be influenced by these control considerations.
The regulatory environment is a key influencing parameter on a firm’s ability to access financing. Many countries in Africa, especially in Sub-Saharan Africa, do not yet have a regulatory framework conducive for the SME sector and especially one that encourages sustainable development. For example, there is no regulatory framework in place in which an SME financing firm can be recognized and licensed as a venture capital firm.

Therefore the SMEs cannot access the associated benefits linked with being a venture capital firm. Because the firm’s status may not be clear, this can further discourage inward investment (United Nations Environment Programme Financial Institutions Initiative [UNEP FI], African Task Force [ATF], World Wide Fund for Nature [WWF] and Geneva International Academic Network [RUIG-GIAN] [2007]).

Variance in regulatory regimes from one country to another exacerbates the problems faced by fund managers in serving SMEs. Well-meaning yet misdirected public policy may distort the market and adversely affect the chances of private players entering the financing market. For example, in Uganda, the government sets limits for interest rates (e.g. 6%) for financing to rural sector based enterprises, which might be lower than the transaction costs of providing financial services to such enterprises (UNEP FI, 2007).

Acumen Fund is a global nonprofit venture operating in Kenya and around the world that fills a niche between traditional capital markets and grant-based philanthropy by investing in enterprises that bring critical goods and services to low-income markets. In Africa, Acumen’s investments have protected 7 million East Africans from
malaria and delivered medical care to 800,000 Kenyans to reduce preventable
diseases (UNEP FI, 2007).

Acumen Fund has learned that financial capital is not enough to support the growth
of sustainable bottom of the pyramid businesses. Entrepreneurs, especially those
working to meet the basic needs of low-income people, need support beyond
financing to grow their businesses.

In particular, as they scale their enterprises, they require talented management
professionals with knowledge of financial accountability, operations, and local
markets. As a result, Acumen Fund is thinking of innovative ways to fill this gap.
This will entail formulating appropriate interventions and the transfer of skills and
knowledge enable more and more small and medium enterprises (SMEs) to become
successful. They help entrepreneurs maximize the profitability of their businesses as
well as assisting them through the challenging times and growth phases. They offer
much more than just money, they offer a complete solution (UNEP FI, 2007).

Root Capital is a nonprofit social investment fund that provides affordable loan
capital and financial training to sustainable grassroots businesses operating in
environmentally-sensitive areas of Latin America, Africa and Asia. Root capital has
recognized a lack of financial skills needed by borrowers to properly manage their
enterprises and interact effectively with buyers and financial institutions.

It target rural producer businesses are generally not familiar with how to report,
analyze, and interpret financial information about assets, liabilities, equity, revenues,
expenses, and cash flows, which act as moderating influences to their ability to
access capital (UNEP FI, 2007).
Training may act as a catalyst in overcoming the limiting aspects of the lack of financial literacy on entrepreneurs. Root Capacity complements and deepens the impact of core lending activities by equipping entrepreneurs with financial and managerial skills to build their businesses and work effectively with suppliers, clients, and commercial financial institutions.

Root Capital is uniquely positioned to develop specialized curriculum, training methodology, and technical assistance for this type of financial education because it understands the needs of and has formed trusting relationships with rural businesses and their buyers. Since 2000, it has already provided a limited amount of this type of technical assistance as part of its lending program (UNEP FI, 2007).

2.5 Sources of Entrepreneurial Finance

There exist primarily four categories of sources through which businesses could access entrepreneurial financing. These include self-finance options, network finance options and institutional finance options. Self-finance options include sources of finance which the entrepreneur could provide through their personal wealth and debt.

Network finance options include funding obtained through relationships with friends, family and colleagues—these two forms of finance constitute the main informal financing options. Institutional financing options are available through banks and other lending agencies. This study focused on whether or not entrepreneurs chose to use self-finance options or institutional financing and focused entirely on the emphasis placed between equity and debt sources.
a. **Formal versus Informal Finance**

Informal finance has been defined as all those financial transactions taking place outside the functional scope of the concerned central monetary authority and other financial sector regulations (Aryeetey, 1995). These include commercial and non-commercial lenders, friends, family and licensed co-operatives or unions. They also include formal and informal groups formed with the aim of raising finances. Factors that influence use of informal finance compared to formal financing are costs of transaction, which will entail transport costs, travel time, time spent at banks etcetera.

The liquidity of financial assets, to the extent that how people save depends on how quickly they can transform these assets to cash. Institutional financing include banks, venture capital organizations (organizations that finance early stage businesses in exchange for equity with the expectation of high potential growth), business angels (wealthy individuals with similar expectations to venture capitalists) and government programs (Orford et al., 2003).

Chipeta and Mkandawire (1991), notes that the informal segments of the financial markets may be larger than the formal ones for many African countries. Thus, in order for reforms to be effective, factors that attract potential savers to informal activities must be embodied in the reform programs. Atieno (1998) has observed in a survey done in Kenya that about 70% of the respondents got their initial capital from family, friends and relatives while 81% got their operating capital from the same financier.
Aryeetey (1995 as reported in Chandavaker, 1989) argues that deposit mobilization can be enhanced through providing strong linkages between the formal and informal savings mobilization units. Aryeetey (1992) concluded that a major constraint to savings mobilization in Ghana was the rather fragmented nature of the financial system.

As such, the functions of savings mobilization and credit allocation were observed to be unrelated among the segments. Thus, the volume of lending that could be undertaken by the system was not directly related to how much saving it could mobilize thereby providing no incentive for continued savings mobilization.

Aryeetey (1995) notes that informal finance is often purpose oriented in that depending on the socio-economic goals of communities, informal arrangements are developed to meet the demand for specific financial services. In general, three broad classifications of types of informal finance are found in Africa.

These are primarily savings mobilization units with little or no lending, lending units that are hardly involved in savings mobilization and units that mobilize deposits and do a considerable amount of lending albeit to members of distinct association or groups.

The latter may include self help financial groups that include different levels of savings and credit organizations such as rotating savings and credit associations (ROSCA’s) and non-rotating ones or accumulating savings and credit organizations (ASCRA’s) as they are referred to in the more recent literature. The main distinction underlying Savings and Credit Associations can be brought out by pointing out ROSCA’s at one end and ASCRA’s at the other.
The former periodically rotate the collection of funds among members whilst the latter accumulates funds that are used for various purposes, including lending. Various combinations of these arrangements such as Commercial lenders, licensed co-operatives or unions, Money keepers and savings collectors, Friends and non-commercial lenders and Family can be found in the middle of the continuum.

Aryeetey (1995) concludes that the major problems for depositors in Africa are those born out of the perception of high transaction costs in saving formally and those to do with uncertainty in dealing with formal systems. It is important to note that these considerations explain the resilience of the activities and ability to adjust their structures to new macro-economic environments in response to consumer demand while the second are more recent and help to explain growth of informal finance as Governments try to reform financial institutions.

b. Debt versus Equity

Equity is one source of capital (funds) a company may use to finance its operations (Higgins, 2001). Many analysts define equity as the net worth of a company: the value of the assets less the value of the liabilities. The value of the equity of a business is whatever remains after the company satisfies all of the claims of its creditors (residual claim).

There are essentially three types of transactions in the equities market. These are an initial public offering, a seasoned offering (both these are primary market transactions), and an investor-to investor sale of securities. In an initial public offering, a privately-held company offers shares in the company through the equity markets for the first time. This is often referred to as "taking a company public."
Debt financing is a major source of capital for most firms. Debt financing occurs when investors provide capital in the form of loans for the managers of a company to use to operate the business. The company, in return, promises to repay the capital to the investors plus a rate of interest for the use of the capital. There are two types of transactions in debt markets.

Banks require the company to have collateral (an asset that is used to secure the loan), but this requirement often is negotiable (Pandey, 1999). If a company is having trouble meeting its obligations, it usually is easier to negotiate new terms for bank financing than for issued securities. This flexibility results from the ongoing relationship between the bank and the company. In entrepreneurial finance, the choice is almost always about whether to use debt or equity financing options, and this will be main focus of this study.

c. **Long Term Finance versus Short Term Finance**

Long term financing is a form of financing that is provided for a period of more than a year (Higgins, 2001). Long term financing services are provided to those business entities that face a shortage of capital. It is different from short term financing which is normally used to provide money that has to be paid back within a year.

The period may be shorter than one year as well. Examples of long-term financing include a 30 year mortgage or a 10-year treasury note. Equity is one form of long-term financing, such as when a company issues stock to raise capital for a new project.

Broadbent and Cullen (2003) observe that sources of long term financing include shares, debentures, public deposits, and retained earnings, term loans from banks
and loans from financial institutions. Shares are issued to the general public. The holders of shares are the owners of the business. These may be of two types Equity and Preference. Debentures are also issued to the general public.

The holders of debentures are the creditors of the company. Public deposits come about since the general public also like to deposit their savings with a popular and well established company which can pay interest periodically and pay-back the deposit when due. Retained earnings arise since the company may not distribute the whole of its profits among its shareholders.

It may retain a part of the profits and utilize it as capital. Term loans from banks are consequence of many industrial development banks, cooperative banks and commercial banks granting medium term loans for a period of three to five years. Finally, loans from financial institutions result from the many specialized financial institutions established by the central and state governments which give long term loans at reasonable rate of interest.

Short-term financing is defined as a loan or credit facility with a maturity of one year or less (Pandey, 1999). It is also defined as a credit arrangement extended to a mortgage banker to finance an inventory of loans that are resold to investors. These include short-term lines of credit from a commercial bank, called a warehouse line; and commercial paper issued by mortgage bankers, known as collateral trust notes. Others include bank overdraft, trade credit, credit cards, leases and bank loans.

d. **Internal Finance versus and External Finance**

Internal sources are often preferable to a firm as they will usually be cheaper and perhaps easier to arrange at short notice (Koch and Macdonald, 2000). However, the
potential for arranging large amounts of finance may be low. The main internal sources are profits and savings from reduced working capital.

The company has to be profitable for this to be a source, and it must be available in cash. Often this is not viable as they may have paid the profit in dividend to the shareholders, or perhaps already tied the money up for other reasons. Once profits are made, tax has to be paid on them. After the tax is deducted the business can decide to do either of two things with them, that is, either distribute them to the owners of the business, or retain them for the future use of the business. It is these retained profits that provide the internal source of finance.

Reduce working capital can be obtained if the firm is able to raise some money from reducing their working capital or investment if they reduce their stock level (through improved stock control) or perhaps improve their credit control and ensure that they collect their debts more promptly and delay payment to creditors for as long as is possible.

Sale of assets or perhaps sale and leaseback - this will depend on the value of the assets, but the firm may either be able to sell surplus assets (if they have any) or perhaps sell existing assets that they use to a specialist leasing company and then lease them back. This will give them access to some capital, though they are then burdened with annual leasing costs.

In the case of external financing, the company can basically either sell share; or borrow finances from banks and/or other financial institutions (Langdon and Bonham, 2004). There are other ways in which externally generated finance can be obtained, but these are the two principle methods, and the fundamental choice facing
the owners of the business. When an investor buys a share, he/she pays over a sum of money that does not have to be given back by the business in return for a share in the ownership of the company.

The obvious advantage of share capital is that it is "non-redeemable" - in other words, as a source of finance it is permanent and never has to be returned. The disadvantage is that in issuing shares the original owners of the business have to accept that other people will own part of their company, and the loss of control that this entails. Of course, if the other partners also bring in other expertise, the loss of control may be a bonus, but partnership is a tricky thing, and it is possible to choose the wrong partner, with woeful consequences.

Koch and Macdonald (2000) observe that bank loans and loans from financial institutions are injections of capital, but this capital does have to be paid back, and at interest. The company does not lose control of the direction of the business, but must generate revenues and profits sufficient to pay off the loan and the interest. If the interest rate is variable, the company could expose itself to changes in interest rates, with increasing costs and a resultant profit squeeze or loss. This is the basic choice facing the directors or owners of any company that seeks further finance.

However, there are a number of variations on these themes. Director's loans: The directors of the company, who are its shareholders, may make a loan into the company. This is not strictly share capital and will have to be paid back, but the loan is made on the understanding that it will only be paid back as and when the company can afford to do so, so really it is part and parcel of the process of obtaining share capital.
Debentures are a form of certificate that can be traded almost as if they were shares (Ortega and Grant, 2003). However, they are not shares but actually a legal form of fixed finance, that is to say, a form of borrowing at a fixed or variable rate of interest from a finance house or possibly another company or wealthy individual.

Property and mortgages: Often a loan is sought from a bank for the specific purpose of purchasing a property, and the company pays the bank a mortgage. This is just a form of bank finance on which interest is charged, but the bank usually secures the loan against the property and this provides both them and the business with some degree of security in the case of business failure.

Companies can choose to buy equipment by means of hire purchase. This means that they do not have to find all the capital for the equipment in one go, but they pay for it as they use it. They are using expected future profits to pay for the capital equipment. The finance is created because creditors are willing to extend credit to the business in the faith that the business will make a profit, so it is a form of loan.

2.5.1 Measurement of Choice of Source of Entrepreneurial Finance

In order to be able to quantify choice, this study compared the entrepreneur’s preference for equity over debt. It is assumed that equity would be the natural source of entrepreneurial financing given its easy availability to entrepreneurs. Therefore, the first recourse of source of financing would be equity. Debt would be used to top up where entrepreneurs lacked sufficient equity capital.

Debt would also come in where the entrepreneur sought to expand their business portfolio. The ratio of equity to debt would thus be indicative of the entrepreneur’s
choice of source of entrepreneurial finance at a given point in time. This point is expounded in detail in the next chapter.

2.6 Critique of the Existing Literature

This study made use of data from Kenya which is a developing market. Theories of entrepreneurial finance have basically evolved in the West where stock markets are more vibrant and the financing instruments are more readily available than in developing markets such as Kenya. Very few entrepreneurial ventures in Kenya have ever received credit from formal financial institutions.

Access is limited due to challenges in assessing SMEs risk in a cost-effective manner. Lenders in Kenya address this risk-assessment problem either by not lending to SMEs at all or by requiring collateral and charging high interest rates.

Developed economies like the US are highly capitalized and this enables small firms to obtain equity financing proportionally greater than debt financing. Considering that the financial infrastructure in Kenya as a developing market is quite different from that in developed markets, there is need for an empirical inquiry to elucidate how entrepreneurial ventures access funds.

Many considerations impact on this issue. One would be the influence of the economy in which the firm is situated. Developing markets like Kenya have less stable and less advanced financial systems compared to developed countries. Information asymmetries may thus be higher, increasing the perception of the risk posed by moral hazard and adverse selection and thus influencing financing decisions.
From the literature review, entrepreneurial firms can be said to possess a wide range of options regarding their financing strategy, especially in the informal finance sector. These include business angels, venture capitalists, family, close relatives and friends. Informal finance in Africa, characterized by endemic levels of poverty is one feasible option especially for entrepreneurial ventures that do not possess the relevant credential’s to access formal sector financing.

Informal finance possesses the advantage of flexibility and convenience. It is affordable and possesses fewer restrictions compared to formal financing avenues. The disadvantage of informal finance is lack of scale. As entrepreneurial firms grow their capital requirements increase and informal sector financing may not possess the necessary capacity to serve such growth.

Again, owing to the high failure rate of these ventures in Africa, the sector may be viewed as a high risk undertaking, discouraging long term commitment by investors. The cost of capital may also be prohibitive for those firms that cannot demonstrate a good track record.

From the review, it can be deduced that Kenya has a weak enterprise finance information system that cannot support, in particular, the information needs of entrepreneurial firms. General knowledge and awareness of finance options available to entrepreneurial firms in Kenya is poor.

This was said to be due to a lack of understanding of what was available, due to fragmented financial information, and lack of targeted awareness and educational schemes with a view to raising the profile of finance issues among the ventures.
Entrepreneurs need information on available bank loans, sources of business finance, loan schemes, information on venture capital and on angel finance.

A key differentiator between the preference for formal and informal finance has to do with information asymmetries. From the perspective of entrepreneurial ventures in Africa, majority of whose owners may lack experience with the operations of formal financing systems, perceptions of ‘hidden’ transaction costs tends to render the formal system susceptible to high levels of suspicion. Entrepreneurs tend to view the formal sector as being costly and time consuming, thus preferring to operate within the informal segment.

2.7 Summary

In summary, the definition of entrepreneurial finance in this study comprises four types of investing seed, start-up, expansion investment, and buy-ins and buy-outs. Specifically, seed capital is used for initial product development and to evaluate the commercial potential of ideas. Start-up investments are made into firms that use more cash than they generate; such firms have normally already launched products in the market, but they are growing quickly and need additional capital. Once the firm has also moved beyond this stage, it becomes a candidate for expansion investments.

These SMEs have established products and need further capital to fund additional investments into R&D or the increase of production capacities. Buy-ins and buy-outs are also more regularly observed for mature companies. In a buy-in, a manager or a team of managers from outside raises venture capital to acquire a stake in the firm and assumes managerial responsibilities.
In a buy-out, the acquiring party already works for the company. These different activities, encompassing changes in the firm’s size, in information requirements, in purpose and costs of financing, will require different levels of capitalization and will therefore, determine capital requirements, and will influence choice of the same.

Small- and medium sized firms face many challenges related to access of entrepreneurial capital. These challenges arise from the many constraints these firms face due to small size over time indicative of low growth potential, a lack of transparency and accountability on the part of their owners that puts off potential lenders, high cost of debt capital, poor business strategy, tight control by the owners and low level of owner education among others.

Most of these firms also lack access to international markets, further limiting their ability to grow. They may need to be more competitive in this sector through value adding processing, elongating their value chain and creating more appeal for their products and services.

Sources of finance have been seen to range from formal to informal sources. The former include institutional sources such as banks and microfinance institutions, while the latter include business angels. In the developing world, such as Kenya, the former constitutes a more important source of financing compared to the latter, and it is believed that creating linkages between the two sectors will enhance savings mobilization and spur economic development. This study attempts to create this linkage by accessing how selected firm characteristics influence choice of sources of finance by entrepreneurial SMEs.
2.8  Research Gaps

The above brief critique, done against the background of the theoretical framework and empirical research only serves to further elaborate on the inconclusive nature of research underlying financing decisions. The review actually presents very many fault lines which could be investigated through empirical enquiry.

These include how taxation regimes, liquidity, firm size industry or sector and so on, influence financing decisions. This study attempted to fill in this gap of how these variables determine financing decisions. This also implies that also the other intervening, confounding and controlling variables are kept constant, a fact that is not the case in reality.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter introduces the research methodology including the research design, population of study, sampling methodology, and the data collection and analysis procedures. The study adopted both a qualitative and quantitative approach. Data analysis was undertaken by means of standardized statistical procedures. Questionnaires were used to capture qualitative and quantitative data from owners or managers of SMEs under consideration. In addition guided interviews were used in cases where owner’s education background makes it difficult to acquire information.

3.2 Research Design

A research design is a plan showing how the problem under investigation will be solved. The function of a research design is to ensure that the evidence obtained enables the study to answer the research question as unambiguously as possible. This study adopted a mixed methods research design.

Such a design entails the use of quantitative and qualitative study approaches. Namusonge (2010) observes that this method is best suited for gathering descriptive information where the researcher wants to know about people or attitudes concerning one or more variables through direct query.

By demonstrating the existence of social problems, competent descriptive survey studies can challenge accepted assumptions about the way things are and can provoke action. Good descriptive research effectively answers the ‘what’ questions that in turn provoke the ‘why’ questions of explanatory research (George and
Bennett, 2005). Since this study had the prime goal of investigating the determinants of sources of entrepreneurial finance for SMEs, it was felt that the descriptive survey design would best help the researcher in achieving this.

### 3.3 Target Population

The population of interest is composed of all SMEs in Thika District registered in the Thika Business Directory (TBD, 2006). This is a total of approximately 800 SMEs belonging in different sectors; manufacturing has 80, 110 are agricultural, essential services that includes private schools and health facilities have 200, general merchandise like shops and supermarkets have 240, commercial services and other service industries are a total of 170. (see table.3.1 below)

Financing institutions like banks and SACCOS are not included since this may conflict the objectives of the study. This is because the study was looking at determinants of sources of entrepreneurial finance. These financing institutions were also left out because they are just branches of large institutions located elsewhere and therefore are not reflective of themselves but rather of their parents elsewhere.

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>80</td>
</tr>
<tr>
<td>Agricultural</td>
<td>110</td>
</tr>
<tr>
<td>Essential Services</td>
<td>200</td>
</tr>
<tr>
<td>General Merchandise</td>
<td>240</td>
</tr>
<tr>
<td>Commercial &amp; Other Service</td>
<td>170</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>800</strong></td>
</tr>
</tbody>
</table>

### 3.4 Sampling Frame

A sampling frame has the property that the researcher can identify every single element and include any in the sample (Saunders et al., 2007). The most
A straightforward type of frame is a list of elements of the population (preferably the entire population) with appropriate contact information. The sampling frame was selected from the category of respondents possessed the required information.

The sampling frame has all the small and medium enterprises in Thika district that have contacts in Thika business directory of 2006, a total of 800 SMEs. This composed of only the small and medium-manufacturing, service SMEs and agricultural SMEs but exempts financing institutions, which formed the researcher’s body of interest.

3.5 Sample Size and Sampling Technique

Stratified random sampling method was used, where the population embraced a number of distinct categories. The frame was organized by these categories into separate “strata” in this case service and manufacturing industries. Each stratum was then sampled as an independent sub-population, out of which individual elements were randomly selected. There are several potential benefits to stratified sampling. First, dividing the population into distinct, independent strata can enable researchers to draw inferences about specific subgroups that may be lost in a more generalized random sample.

Second, utilizing a stratified sampling method can lead to more efficient statistical estimates (provided that strata are selected based upon relevance to the criterion in question, instead of availability of the samples). It is important to note that even if a stratified sampling approach does not lead to increased statistical efficiency; such a tactic didn’t result in less efficiency than would simple random sampling, provided that each stratum is proportional to the group’s size in the population.
Third, it is sometimes the case that data are more readily available for individual, pre-existing strata within a population than for the overall population; in such cases, using a stratified sampling approach may be more convenient than aggregating data across groups (though this may potentially be at odds with the previously noted importance of utilizing criterion-relevant strata).

Finally, since each stratum was treated as an independent population, different sampling approaches can be applied to different strata, potentially enabling researchers to use the approach best suited (or most cost-effective) for each identified subgroup within the population.

There are, however, some potential drawbacks to using stratified sampling. First, identifying strata and implementing such an approach can increase the cost and complexity of sample selection, as well as leading to increased complexity of population estimates. Second, when examining multiple criteria, stratifying variables may be related to some, but not to others, further complicating the design, and potentially reducing the utility of the strata.

Finally, in some cases (such as designs with a large number of strata, or those with a specified minimum sample size per group), stratified sampling can potentially require a larger sample than would other methods (although in most cases, the required sample size would be no larger than would be required for simple random sampling.

A stratified sampling approach is most effective when three conditions are met. These are variability within strata are minimized, variability between strata are
maximized and the variables upon which the population is stratified are strongly correlated with the desired dependent variable.

The variable used for stratification was industry, which is, service, manufacturing and trade. This is because of the fact that studies have demonstrated that the factors that influence determinants of financing will be industry dependent.

The study involved undertaking statistical analyses on the sample to enable inferences about the population to be made on the basis of the sample. As the distribution of each of the various population characteristics was not known, a sample size that ensured inferences about the population characteristics could be made on the basis of the sample was taken.

Saunders et al. (2007), explains that provided samples are not biased, by the law of large numbers, samples of larger size are more likely to be representative of the population from which they are drawn than smaller samples. Statisticians have also proved that the larger the absolute size of a sample, the more closely its distribution will be to the normal distribution and thus the more robust it will be (Namusonge, 2010; Saunders et al., 2007).

This relationship, known as the Central Limit Theorem, occurs even if the population from which the sample is drawn is not normally distributed. The Central Limit Theorem provides that when the sample size is at least 30, the approximation to the normal distribution of the sample means is complete and the confidence interval for the population parameter of interest can be determined from the sample mean at a specified level of confidence (Namusonge, 2010; Mason et al., 1999).
However, notwithstanding the above sample size on the basis of the Central Limit
Theorem, the selected sample size was also guided by the 5% level of significance at
which the formulated hypotheses were to be tested. The level of significance is the
statistical standard which is specified for rejecting the null hypothesis (Namusonge,
2010). At this level of significance the level of confidence is 95%. This is the level
of confidence normally used for research in social science (Saunders et al., 2007).

According to Mugenda and Mugenda (1999) the sample size for a population of
10,000 or more can be computed as per the formula below:

\[ n = \frac{pqz^2}{e^2} \]

Where,

- \( n \) = Minimum Sample Size
- \( p \) = Population proportion with given characteristic
- \( z \) = Standard normal deviate at the required confidence level
- \( e \) = Error Margin

Mugenda and Mugenda (1999, as contained in Fisher, Laing and Styoeckel, 1983)
recommend that since \( p \) and \( q \) are unknown, both are set at 50%. At a con-
fidence level of 95% that will be used for this study, \( z = 1.96 \) and the sampling error of \( e = \pm 5\% \). Thus, sample size \( n \) becomes:

\[ N = 50*50*(\frac{1.96}{5})^2 = 384 \]

For a population less than 10,000 the population is computed as per the formula
below:

\[ n_f = n/(1+n/N) \]

Where, \( n_f = \) desired sample size when the population is less than 10,000
n = sample size (when the population is greater than 10,000) = 384

N = estimate of the population size

Using the above formula, the sample size is 259 as shown in table 3.2

Table 3.2: Sampling Distribution

<table>
<thead>
<tr>
<th>Sector</th>
<th>Population</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>80</td>
<td>25</td>
</tr>
<tr>
<td>Agricultural</td>
<td>110</td>
<td>36</td>
</tr>
<tr>
<td>Essential Services</td>
<td>200</td>
<td>65</td>
</tr>
<tr>
<td>General Merchandise</td>
<td>240</td>
<td>78</td>
</tr>
<tr>
<td>Commercial &amp; Services</td>
<td>170</td>
<td>55</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>800</strong></td>
<td><strong>259</strong></td>
</tr>
</tbody>
</table>

The computed sample size was 259 respondents. This sample size comprised 32.3% of the target population which was sufficiently large even for descriptive studies for which the minimum sample size is 10% (Saunders et al., 2007).

The researcher distributed 280 questionnaires in order to compensate for the potential non-respondents. A total of 239 respondents filled the questionnaire. Therefore, the response rate was 85.4%, which is quite high compared to the commonly expected response rate of 50-75% for questionnaires delivered by hand (Saunders et al., 2007).

3.6 Data Collection Instruments

The research instrument was a questionnaire. Kothari (1993) highlights that a questionnaire gives the respondents’ adequate time to give well thought out answers. The questions in the questionnaire are a mixture of open-ended, forced response types and matrix type (Likert-type scales). Kothari and Pals (1993), note that whereas the open-ended types of questions give respondents freedom of response, the forced types facilitate consistency of certain data across respondents.
Likert-type questions served to assess the extent of persuasiveness of given campaign materials. The questionnaire was ideal for the descriptive survey, as it enabled quick collection of similar data across a relatively dispersed population. Using a predesigned questionnaire ensured that information sought was relevant to the objectives of the research, was standard and focused the research on collecting the information rather than thinking about what information to collect.

3.7 Data Collection Procedures

A questionnaire was developed. The aim of the questionnaire was to collect information relating to how various factors influence sources of entrepreneurial finance of the SMEs. The instrument was addressed to the owners or finance managers or their designated backups; the “drop and pick later” method was used. Interviews were also used together with questionnaires depending on the level of education of the owner. This increased the validity of data collected.

Questionnaires were self-administered to a cross-section of more than 260 owners or managers in all SMEs randomly selected from Thika district. These are the total number of managers and owners who agreed to participate in the study. Saunders et al, (2007) state the statistical rule of thumb that a sample size of 30 units is representative of any population.

Also, according to Mugenda and Mugenda (1999), a response rate of 50% is considered sufficient. In this study, however, a total of 239 participants filled the questionnaire out of the expected 259 sample size, which accounted for 92.3% of the targeted SMEs. In view of Wayne and Terrels (1975) and Mugenda and Mugenda
(1999) arguments, the study adopted this response rate as being necessary and sufficient.

Table 3.3: Respondents by Location

<table>
<thead>
<tr>
<th>Location</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Juja</td>
<td>37</td>
<td>15.2</td>
</tr>
<tr>
<td>Ruiru</td>
<td>42</td>
<td>17.8</td>
</tr>
<tr>
<td>Thika</td>
<td>157</td>
<td>66.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>236</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Questionnaires were administered to the owners and managers and those who encountered difficulties filling the questionnaire due to their low level of education were interpreted for.

3.8 Pilot Test

The research instruments were pre-tested using a sample size of 26 respondents as per recommendations by Mugenda and Mugenda (1999) who observe that a successful pilot study was uses 1% to 10% of the actual sample size. The respondents were SMEs in the population with similar characteristics to, but not those that were used in the main study. These respondents were selected from a sample that was similar to the one under study.

Subjects from the actual sample were not used in the pre-test. Procedures used in pre-testing the questionnaire were similar to those used in the actual study. This helped in clarifying questions and in refining the data analysis methods (Mugenda and Mugenda, 1999).
3.9 Data Processing and Analysis

Analysis of the data was done using a combination of designs including descriptive statistics which included means, standard deviations, frequencies and percentages and inferential analysis in the form of Pearson’s Chi-square test of association and logistic multiple regression.

The latter determined the probability of the entrepreneur choosing between equity and debt financing options. Graphical illustrations were deployed to enhance the findings. According to Mugenda and Mugenda (1999) descriptive statistics enable meaningful description of a distribution of scores or measurements using a few indices or statistics.

Mean values informed the researcher on the expected score or measure from a group of scores in a study. Standard deviations informed the analyst about the distribution of scores around the mean of the distribution. The frequency distribution and percentages recorded the number of times a score occurs and the extent of occurrence of a particular observation respectively.

The study sought to isolate the determinants of choice of sources of entrepreneurial financing of SMEs. From the literature review, there are various factors that determine the sources of financing of SMEs such as size, information availability, purpose and cost of financing.

The Pearson’s Chi-square Test of Association ($\chi^2$) is used to test for the significance of relationships between variables cross-classified in a bivariate table. The Chi-square test results in a chi-square statistic that informs on the degree to which the conditional distributions (the distribution of the dependent variable across different
values of the independent variable) differ from what would be expected under the assumption of statistical independence.

In other words, as in any hypothesis tests, we are setting up a null hypothesis and trying to reject it, on the basis of the evidence from the sample. In this case, the null hypothesis says that there is no relationship between the variables in our bivariate table (i.e., that source and choice of source of financing and firm size are statistically independent) and that any difference between the conditional distributions that we see is actually just due to random sampling error. If the null hypothesis is rejected, this will lend support to the research hypothesis that there is a real relationship between the variables in the population from which the sample is drawn.

The computations normally make two key assumptions, that is, none of the expected values (as computed) may be less than 1 and no more than 20% of the expected values may be less than 5. The chosen alpha level for the analysis was 0.05 (α=0.05). The decision rule was that if the exact probability was less than the critical alpha level (p<α), the finding was significant and the null hypothesis was rejected.

If the exact probability was greater than the critical alpha level (p>α), the finding was not significant and the study failed to reject the null hypothesis. Where the finding is significant, then the probability that the relationship happened by chance is very small and the difference is real. When the finding is not significant, then the probability is high that the difference or relationship happened by chance.

The independent samples t-test, which compares the means between two unrelated groups on the same continuous, dependent variable, was used. The SPSS t-test procedure allows the testing of equality of variances (Levene's test) and the t-value
for both equal- and unequal-variance. It also provides the relevant descriptive statistics.

The assumptions underlying the T-test were that independent variable consists of two independent groups, the dependent variable is either interval or ratio, the dependent variable is approximately normally distributed and similar variances between the two groups (homogeneity of variances) (tested for in this t-test procedure).

Logistic regression is useful for situations in which the researcher wants to be able to predict the presence or absence of a characteristic or outcome based on values of a set of predictor variables (Dayton, 1992). It is similar to a linear regression model but is suited to models where the dependent variable is dichotomous.

Logistic regression coefficients can be used to estimate odds ratios for each of the independent variables in the model. Logistic regression is applicable to a broader range of research situations than discriminant analysis. The final form, of the model enables the researcher to predict value of the outcome binary variable given values of the explanatory variables.

\[
\text{Logit (p)} = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon_0
\]

Where:

\( p \) = The probability of taking equity

\( 1-p \) = The probability of taking debt

\( \beta_0 \) = Constant

\( \beta_1 \) = Coefficient of firm size

\( \beta_2 \) = Coefficient of information availability
\[ \beta_3 = \text{Coefficient of purpose of finance} \]
\[ \beta_4 = \text{Coefficient of cost of finance} \]
\[ \varepsilon_0 = \text{Error term assumed to be a constant} \]

The above multiple logistic regression equation gave us the relationship between the dependent variable and the four independent variables. More specifically, regression analysis helped us understand how the dependent variable changes when any one of the independent variables is varied, while the other independent variables are held fixed.

The constant error term is representative of any other moderating variables that may affect the relationship between choice of equity and debt, but which were not factored into the causal relationship. Regression analysis assisted us understand which among the independent variables are related to the dependent variable, and to explore the magnitude and direction of these relationships.

Also, the analysis generated odds ratio statistics, which inform us on the likelihood of the predictor variable such as Call cost, in influencing choice of source of finance, in this case, choosing equity over debt. Where the odds ratio was greater than 1 and a significant p-value, then the likelihood would be that of choosing equity over debt. The converse is also true, that is, an odds ratio of less than one represents a less likelihood of choosing equity.

The study also attempted to determine the effect of the moderating variables of entrepreneur personal characteristics on the source and choice of source of entrepreneurial finance. These personal characteristics included the entrepreneur’s gender, business status, religion, and level of education. In order to test whether the
moderating variables had any moderating effect, the study fitted sub-models for each category to compare the goodness of fit with the overall regression model.
CHAPTER FOUR

4.0 RESULTS AND DISCUSSION

4.1 Introduction
This chapter presents the results of statistical analysis along with discussion contextualized in the light of previous studies done in the area. The study had five research questions; to determine the effect of firm size on the choice of source of entrepreneurial finance; to investigate the effect of information availability on the choice of source of entrepreneurial finance; to find out the effect of purpose of finance on the choice of source of entrepreneurial finance; to evaluate the effect of cost of finance on the choice of source of entrepreneurial finance; and to investigate the effect of entrepreneurs personal characteristics on the choice of source of entrepreneurial finance.

4.2 Response Rate
After data coding and entry and as a prelude to data analysis, data was explored to isolate any outliers and to identify and rectify any consistency errors. On the whole, three respondent SMEs were found to lie outside the definition adopted for the target SMEs. The SMEs in this study were to consist of a maximum of 250 employees.

These three SMEs had numbers greater than 250, thus distorting the findings and were thus removed from the analysis. Out of the 239 questionnaires received, only 236 were thus retained. The overall response rate was thus found to be 84.3% which is quite high compared to the usually expected response rate of 50-75% for hand delivered questionnaires (Saunders et al., 2007).
A. Descriptive Results

4.3 Entrepreneurs Bio-Data

This section discusses the results of the general information about the entrepreneur including the period the entrepreneur has been in the firm, the gender and the entrepreneur’s status in the business, their religion and the education level. These characteristics appeared to have some moderating influence on the source of entrepreneurial finance.

4.3.1 Gender

![Figure 4.1: Respondents by Gender](image)

As shown in figure 4.1 among the overall respondents, 35% were female while 65% were male. Since the sample was drawn at random, it can be concluded that there were more male entrepreneurs compared to female entrepreneurs. A goodness of fit test with regard to gender yielded a chi value ($\chi^2=20.260$, df=1, $p<0.001$) which was significant.
This implies that the gender proportions in the sample as drawn differed significantly from the population proportions which were set at 50% (equal proportions of male and female as expected in the population). Thus, care will be exercised in attempting to generalize the findings of the study especially for those which gender may be a determinant.

The next level of analysis aimed at determining whether there was any association between various entrepreneur characteristics and the choice of various sources of financing. In order to accomplish this, the Chi Square Test of Independence which tests the association between the categorical variables, gender and choice of various sources of entrepreneurial finance were computed.

The findings for gender were not significant ($\chi^2=0.678$, df=2, p=0.712) indicating no statistically significant association between gender and choice of source of entrepreneurial finance. Any observed association may have been due to chance but not driven by any systematic association or pattern between gender and choice of type of financing.
4.3.2 Status in the Business

Figure 4.2: Status in the Business

Of all those who answered this question, 88% were the actual SME owners and 12% were Chief Executive Officers (see figure 4.2). This is advantageous as having more owners will result in a higher level of validity of the information received as these were well versed with all the challenges that go with doing the business since its inception. Pearson’s Chi-square test for revealed that the association between choice of source of finance and business status was not significant ($\chi^2=4.895$, df=2, $p=0.087$). Thus any observed relationship was due to chance.

4.3.3 Level of Education

Table 4.1: Level of Education

<table>
<thead>
<tr>
<th>Entrepreneur Level of education</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>University</td>
<td>76</td>
<td>32.48</td>
</tr>
<tr>
<td>Tertiary</td>
<td>97</td>
<td>41.45</td>
</tr>
<tr>
<td>Secondary</td>
<td>55</td>
<td>23.5</td>
</tr>
<tr>
<td>Primary</td>
<td>4</td>
<td>1.71</td>
</tr>
<tr>
<td>Less than Primary</td>
<td>2</td>
<td>0.85</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>234</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
Tertiary level education (such as colleges and polytechnics) was the most common, followed by university level education, then secondary level (see table 4.1). Going by what was discussed in the literature review, we can make the general conclusion that a large percentage of the entrepreneurs were well educated and as a consequence, would be able to choose debt.

Debt financing requires ability to present ones case to the borrower mostly in writing and an ability to understand lending requirements. This criterion is well enhanced by a good education. Pearson’s Chi-square findings were also not significant \( \chi^2 = 4.735, \text{ df}=8, p=0.785 \), thus there was no association between choice of source of financing and entrepreneurs level of education.

4.3.4 Religion of the Entrepreneur

Table 4.2: Entrepreneurs Religion

<table>
<thead>
<tr>
<th>Entrepreneur Religion</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Catholic</td>
<td>79</td>
<td>39.7</td>
</tr>
<tr>
<td>Pentecostal</td>
<td>40</td>
<td>20.1</td>
</tr>
<tr>
<td>Anglican</td>
<td>74</td>
<td>37.2</td>
</tr>
<tr>
<td>Muslim</td>
<td>6</td>
<td>3.0</td>
</tr>
<tr>
<td>Others</td>
<td></td>
<td>8.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td></td>
</tr>
</tbody>
</table>

As shown in table 4.2 majority of the respondents were Catholic (39.70%), followed by Anglican (37.20%), Pentecostal (20.10%) and Muslim (3%). Among the “other” religions category, majority of the respondents were Presbyterian, followed by Evangelicals and Baptist. The other categories were tied. Religion did not show any statistically significant association with choice of source \( \chi^2 = 1.808, \text{ df}=6, p=0.937 \). The findings were not significant for any of the entrepreneurs’ competencies, implying that the entrepreneurial competencies cited above did not influence choice of source of entrepreneurial financing.
Figure 4.3: Borrower Aspects Queried When Borrowing

The above diagrams investigate whether borrowers ever obtained any form of finance where gender was a qualification, where lender required a certain level of education to qualify, whether the lender inquired about borrower’s business status when borrowing money and whether borrower ever borrowed money from a lender who preferred a certain religion.

Business status was the lending criterion most widely cited having been inquired about by potential lenders. It may be of help to lenders where they are dealing with SME owners or those who hold vested interests in the SMEs since they will be determined to see their SMEs succeed and they will gain through increased shareholder value. Education, gender and religion then followed in that order (see figure 4.3).

4.4 SMEs’ Bio-Data

4.4.1 Number of Years in Business

The entrepreneurs were requested to give information on the number of years they have been in business. The results are presented in Table 4.3
Table 4.3: Duration in Years

<table>
<thead>
<tr>
<th>Time in firm</th>
<th>Min.</th>
<th>Percentile 25</th>
<th>Median</th>
<th>Percentile 75</th>
<th>Percentile 95</th>
<th>Max.</th>
<th>Mean</th>
<th>Std Dev.</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>15</td>
<td>35</td>
<td>5</td>
<td>5</td>
<td>221</td>
</tr>
</tbody>
</table>

Up to 25% of the respondents had spent at most 2 years working in the SMEs; at the median value, up to 50% had worked for at most 4 years; up to 75% had done at most 6 years. The longest time served was 35 years. The mean value for all the responses was 5 with a standard deviation of 5.

4.4.2 Number of Employees in the Firm

Table 4.4: Number of Employees

<table>
<thead>
<tr>
<th>No. of staff (2011)</th>
<th>Min.</th>
<th>Percentile 25</th>
<th>Median</th>
<th>Percentile 75</th>
<th>Percentile 95</th>
<th>Max.</th>
<th>Mean</th>
<th>Std Dev.</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>5</td>
<td>12</td>
<td>120</td>
<td>6</td>
<td>13</td>
<td>220</td>
</tr>
<tr>
<td>No. of staff (2010)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>12</td>
<td>120</td>
<td>5</td>
<td>14</td>
<td>201</td>
</tr>
<tr>
<td>No. of staff (2009)</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td>13</td>
<td>120</td>
<td>6</td>
<td>15</td>
<td>162</td>
</tr>
</tbody>
</table>

The upper limit of absolute staff numbers has remained constant from 2009 to 2011 (at 120 staff). The mean value likewise demonstrates little change, whereas the high standard deviations implied that the data points were widely dispersed about the mean, implying high variability regarding the number of employees per firm. Roughly 75% of the SMEs had up to 5 members of staff.

It can be concluded that most SMEs had between 1 and 5 members of staff. Those that had above 5 members of staff were roughly 25%. Increasing employee numbers over time reflect a SMEs growth potential, so the findings of this study would indicate low levels of growth of these SMEs (see table 4.4).
4.4.3 Business Ownership

Of the respondent SMEs, 97.80% were not listed in the Nairobi Stock Exchange (NSE) while only 2.20% trade at the NSE. The implication in terms of sources of financing is that majority of the SMEs depend on private sources of capital, either in form of debt from commercial banks or equity from savings, family or friends, Thus, these SMEs do not access public sources of financing that are associated with listing in the stock exchange.

![Figure 4.4: Ownership Composition of the SMEs](image)

Regarding foreign versus local ownership, locally owned SMEs were the majority. Among the public versus private SMEs, publicly owned SMEs were the overwhelming majority. Finally, with respect to individual versus groups, most of the SMEs were owned by individuals. Indeed (see figure 4.4) this questionnaire item received the highest response rate in this category (n=218)
### 4.4.4 Number of Directors

Table 4.5: Number of Directors

<table>
<thead>
<tr>
<th>Number of Directors</th>
<th>Frequencies</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>171</td>
<td>79.5</td>
</tr>
<tr>
<td>2</td>
<td>35</td>
<td>16.3</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>1.9</td>
</tr>
<tr>
<td>4</td>
<td>3</td>
<td>1.4</td>
</tr>
<tr>
<td>7</td>
<td>2</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>215</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Majority of the respondent SMEs had one director, followed by those which had two as shown in table 4.5

### 4.4.5 Number of Branches

Table 4.6: Number of Branches

<table>
<thead>
<tr>
<th>Number of Branches</th>
<th>Frequencies</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>1</td>
<td>1.6</td>
</tr>
<tr>
<td>1</td>
<td>47</td>
<td>73.4</td>
</tr>
<tr>
<td>2</td>
<td>16</td>
<td>25.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>64</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The majority of the SMEs had a single branch each, followed by those that had two branches (see table 4.6). Again, number of branches can be linked to a firm’s growth strategy as enshrined in its vision and mission statements. Most SMEs were limited in geographical spread to single branches each.

### 4.4.5 Type of Firm

The SMEs were almost equally split between trading sector and the service sector. Manufacturing constituted a very small minority of the respondent SMEs (as shown in table 4.7).
Table 4.7: Type of Firm

<table>
<thead>
<tr>
<th>Type of firm</th>
<th>Frequencies</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service</td>
<td>111</td>
<td>50</td>
</tr>
<tr>
<td>Trade</td>
<td>102</td>
<td>46</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>221</td>
<td>100</td>
</tr>
</tbody>
</table>

4.4.6 Monthly Expenditure

Table 4.8: Average Monthly Expenditure for the Years 2009-2011

<table>
<thead>
<tr>
<th></th>
<th>Min</th>
<th>Median</th>
<th>Percentile 75</th>
<th>Max</th>
<th>Mean</th>
<th>Std Dev.</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>2500</td>
<td>40000</td>
<td>60000</td>
<td>700000</td>
<td>104,553</td>
<td>520777</td>
<td>217</td>
</tr>
<tr>
<td>2010</td>
<td>2000</td>
<td>35000</td>
<td>56750</td>
<td>300000</td>
<td>73,628</td>
<td>233283</td>
<td>192</td>
</tr>
<tr>
<td>2009</td>
<td>1200</td>
<td>30000</td>
<td>50000</td>
<td>300000</td>
<td>70,940</td>
<td>256793</td>
<td>146</td>
</tr>
</tbody>
</table>

The mean value of the average monthly expenditure has shown a gradual increase from 2009 to 2011 (see table 4.8). The very high standard deviations demonstrate a wide dispersion around the mean of the distribution, implying that actual average monthly expenditures differ widely. The percentile values reflect this trend.

Twenty five percent of the SMEs used between KSh. 1,200 to KSh. 15,000 in salaries and rent in 2009. In the same year, 50% paid between KSh. 1,200 and KSh. 30,000 while about 20% of the top tier spent between KSh. 50,000 and KSh. 169,500. In 2010, 25% of the SMEs used between KSh. 2,000 and KSh. 18,000 in salaries and rent.

For this year, 50% spent between KSh 2,000 to KSh. 35,000 in salaries and rent. About 20% on the upper percentiles sent between KSh. 56750 to KSh. KSh. 200,000 in salaries and rents. In 2011, 25% of the SMEs used between KSh. 2,500 and KSh. 20,000 in salaries and rent.
Up to 50% spent between KSh. 2,500 and KSh. 40,000, while at the top tier, 20% spent between KSh. 60,000 and KSh. 186,000 on salaries and rent. The expenditure figures are congruent with the figures for employee numbers, and their low values in both cases indicate low levels of growth.

4.4.7 Major Sources of Funds

In 2011, sources of equity far outstripped the sources of debt. In 2010, the entrepreneurs chose slightly more debt than equity. In 2009, debt and equity sources were evenly matched. The situation in 2011 can be explained by the high interest rates in the market for that year, which may have forced entrepreneurs to retreat to the more affordable equity sources.

4.5 Results and Discussion on the Study Objectives

The following section reports the findings of the study in light of the research objectives as enumerated earlier.

4.5.1 The Effect of Firm Size on Choice of Source of Entrepreneurial Finance

This section investigates the findings relating to the effect of firm size on choice of source of entrepreneurial finance.
Table 4.9: Number of Employees Other Than Owner

<table>
<thead>
<tr>
<th>Min</th>
<th>Percentile</th>
<th>Max</th>
<th>Mean</th>
<th>Std Dev</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>2.0</td>
<td>3.0</td>
<td>4.0</td>
<td>11.0</td>
<td>120</td>
</tr>
</tbody>
</table>

As shown in 4.9 the mean value of employees per firm was 4.81 but with a high standard deviation value indicative of the fact that actual numbers of employees among most of the SMEs differed widely. From the percentile values, we see that roughly 75% of the SMEs had up to 4 employees other than the owners. Only a handful (less than 5%, had more than 11 employees other than the owners). This has the same implication for growth as cited earlier.

Table 4.10: Estimate of SMEs Assets

<table>
<thead>
<tr>
<th>Min</th>
<th>Percentile</th>
<th>Max</th>
<th>Mean</th>
<th>Std Dev</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>100000</td>
<td>300000</td>
<td>700000</td>
<td>1.5M</td>
<td>25M</td>
</tr>
</tbody>
</table>

A quarter of the respondent SMEs had assets in the range of KSh. 100,000, while up to half of the SMEs had estimated assets values of up to KSh. 300,000. Majority of the SMEs lay with the 75th percentile characterized by estimated assets values of KSh. 700,000. Roughly 5% of the respondent SMEs had assets estimated between KSh. 1.5 million and 3.55 million, while only a further 5% had estimated assets that exceeded 3.55M in value (see table 4.10). The high standard deviation reflects this pattern of high dispersion about the mean value.
Table 4.11: Average Gross Monthly Profit Last Five Years

<table>
<thead>
<tr>
<th>Min</th>
<th>25</th>
<th>50</th>
<th>75</th>
<th>90</th>
<th>95</th>
<th>Max</th>
<th>Mean</th>
<th>SD</th>
<th>Valid N</th>
</tr>
</thead>
<tbody>
<tr>
<td>1500</td>
<td>20000</td>
<td>40000</td>
<td>92500</td>
<td>200000</td>
<td>362500</td>
<td>4M</td>
<td>119946</td>
<td>388844</td>
<td>214</td>
</tr>
</tbody>
</table>

Most of the respondent SMEs registered profits below KSh. 100,000. These lay between the 75\textsuperscript{th} and the 90\textsuperscript{th} percentile. Less than 5\% of the respondent SMEs registered profits in excess of KSh. 350,000 as shown on table 4.11. The high standard deviation figure indicates a wide dispersion about the mean of the distribution.

Table 4.12: Influence of Size Parameters on Sources of Finance

<table>
<thead>
<tr>
<th>Size Parameters</th>
<th>SA</th>
<th>A</th>
<th>N</th>
<th>D</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff no influence</td>
<td>18.7%</td>
<td>23.3%</td>
<td>9.6%</td>
<td>35.2%</td>
<td>13.2%</td>
</tr>
<tr>
<td>Profit influenced</td>
<td>27.1%</td>
<td>33.8%</td>
<td>10.5%</td>
<td>25.7%</td>
<td>2.9%</td>
</tr>
<tr>
<td>Age influenced</td>
<td>20.9%</td>
<td>33.6%</td>
<td>16.4%</td>
<td>24.1%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Sales no influence</td>
<td>8.1%</td>
<td>16.2%</td>
<td>21.2%</td>
<td>41.0%</td>
<td>13.5%</td>
</tr>
<tr>
<td>Expansion influenced</td>
<td>9.5%</td>
<td>18.5%</td>
<td>29.7%</td>
<td>36.9%</td>
<td>5.4%</td>
</tr>
</tbody>
</table>

Key: SA=Strongly Agree (5); A=Agree (4); N=Neutral (3); D=Disagree(2); SD=Strongly Disagree(1)

The aim here was to determine how certain statements that related to the perceived effect of business size parameters on choice of source of entrepreneurial finance were ranked by the respondents. These include the number of employees, gross profit, the age of the business, the annual average turnover in sales of the business and the expansion of the business in terms of branches. The statements were structured so as to reflect either influence or no influence. The accepted responses were strongly disagree (SD), disagree (D), neutral (N), agree (A) and strongly agree (SA).
Majority of the respondents disagreed with the notion that the number of employees did not influence where the firm obtained its finance, with most of these (35.20%) registering disagreement (see table 4.12). With respect to the issue of whether gross profit influenced where the firm acquired its finance, the majority opinion was that gross profit influenced choice of source of entrepreneurial finance. Of these respondents, most (33.80%) were in agreement with that gross profit influenced choice of source of entrepreneurial finance.

One third of the respondents (33.60%) agreed that the age of business determined source of finance. Forty one percent (41%) of the respondents disagreed that annual average turnover in sales of business influenced the source of entrepreneurial finance. A majority of 63.10% agreed that the expansion of the business in terms of branches influenced where the firm obtained finance while 36.90% disagreed.

Table 4.13: Mean Values of Size Parameters Influence

<table>
<thead>
<tr>
<th>Determinants of firm size</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales volumes did not influence</td>
<td>3.36</td>
<td>1.147</td>
<td>222</td>
</tr>
<tr>
<td>Expansion influenced</td>
<td>3.10</td>
<td>1.069</td>
<td>222</td>
</tr>
<tr>
<td>Number of employees did not influence</td>
<td>3.01</td>
<td>1.368</td>
<td>220</td>
</tr>
<tr>
<td>Age of the entrepreneur determined</td>
<td>2.59</td>
<td>1.204</td>
<td>210</td>
</tr>
<tr>
<td>Profitability of the firm influenced</td>
<td>2.43</td>
<td>1.217</td>
<td>219</td>
</tr>
<tr>
<td>Valid n (list wise)</td>
<td></td>
<td></td>
<td>199</td>
</tr>
</tbody>
</table>

The mean values for each of the four statements are shown in table 4.13. The mean values represent points of convergence of the different respondents opinions regarding the influence of the stated parameters on choice of source of entrepreneurial finance. The measures inform the research on where most of the opinions tended to cluster around. The values were rounded off to the nearest integer and interpreted according to the points on the Likert scale that these corresponded to.
The statement ‘annual average turnover in sales of business did not influence the source of entrepreneurial finance’ as an assertion had an overall rating of ‘neutral’ on our scale (mean of 3.36). These means that there was no implicit influence of growth in sales on choice of source of finance for the entire respondents, although for individual SMEs, the observation will vary widely as shown by the standard deviations.

The same analysis is repeated for the other variables. When rounded off, and compared to corresponding points on the Likert scale, all the proxies that represented size except ‘profit’ were considered neutral. In the case of profit, the respondents registered general agreement in that gross profit influenced where the firm got its finances.

Table 4.14: Effect of Business Size on Source of Entrepreneurial Finance

<table>
<thead>
<tr>
<th>Effect of Business Size</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Extent</td>
<td>66</td>
<td>29.3</td>
</tr>
<tr>
<td>Small Extent</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>Moderate Extent</td>
<td>39</td>
<td>17.3</td>
</tr>
<tr>
<td>Great Extent</td>
<td>104</td>
<td>46.2</td>
</tr>
<tr>
<td>Greatest Extent</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>225</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

When asked to rate how business size in general has influenced entrepreneur’s decision on where to apply for entrepreneurial finance as shown in table 4.14, a majority of 46.2% of the entrepreneurs responded that this consideration influenced them to a great extent. A significant proportion of 29.3% also felt that business size was not a consideration in deciding on where to apply for entrepreneurial finance. A moderate level of influence of size on financing was registered by 17.3% of the respondents. This distribution had a mean of 2.94 (moderate extent) and a standard deviation of 1.358.
From figure 4.6 below, the majority of the respondents (66.80%) were of the opinion that the size of the business improved the entrepreneur’s ability to access sources of financing. A smaller, but still significant number (29.20%) reported no effect with regard to the effect of size on their ability to access sources of financing.

![Chart showing the effect of business size on entrepreneur's choice of sources of finance]

Figure 4.5: Effect of Business Size on Entrepreneurs Choice of Sources of Finance

As shown in figure 4.5, 66.80% of the respondent felt that the size of the firm influenced the ability to access source of finance, while only 0.40% felt that their access to finance was made worse by the size of their firm. Thus, respondents generally shared the opinion that size improved their choice of source of entrepreneurial finance.

### 4.5.2 The Effect of Information Availability on Choice of Source of Entrepreneurial Finance

Table 4.15: Selected Sources as Information Sources

<table>
<thead>
<tr>
<th>Sources of Information Availability</th>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal enquiries</td>
<td>60.20%</td>
<td>39.80%</td>
</tr>
<tr>
<td>Local FI, exhibitions &amp; shows</td>
<td>60.90%</td>
<td>39.10%</td>
</tr>
<tr>
<td>Radio stations</td>
<td>86.40%</td>
<td>13.60%</td>
</tr>
<tr>
<td>Newspapers/ magazines &amp; journals</td>
<td>90.80%</td>
<td>9.20%</td>
</tr>
</tbody>
</table>
The majority of the respondents did not view local radio stations as a source of information on potential sources of entrepreneurial finance. An equally large percentage of the respondents unanimously opined that newspapers and magazines were not a source of information.

As shown on table 4.15 most of the respondents (60.90%) did not view local exhibitions and shows as sources of information. A significant smaller number (39.10%) did not share this opinion. A majority (60.20%) did not consult friends and colleagues for information on potential sources of entrepreneurial finance. A significant number however, did consult from those around them.

![Figure 4.6: Sources led to by the Various Information Sources](image)

As shown in figure 4.6 above, local radio as a source of information resulted in the entrepreneurs choosing more debt (commercial banks) than equity in the form of SACCOs and personal savings. Print media mainly led entrepreneurs to sources of debt predominantly banks. Local shows and exhibitions mainly led to a majority of debt sources (bank borrowings) and a minority of equity sources such as SACCOs. Personal contacts led entrepreneurs to not so dissimilar proportions of debt in form of bank borrowings and equity in form of SACCOs and savings.
Personal enquiries were by far the source of information that led entrepreneurs to the highest source of equity financing compared to the others. The mass media forms of advertising such as electronic and print media are normally paid forms of advertising accessible to lenders and will naturally be the channels through which lenders will reach borrowers. Personal contacts, on the other hand, will lead to equity as well as debt sources depending on what is sought.

Table 4.16: Influence of Information on Sources on Choice of Source of Finances

<table>
<thead>
<tr>
<th>Information Sources</th>
<th>No extent</th>
<th>small extent</th>
<th>moderate extent</th>
<th>great extent</th>
<th>greatest extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Radio stations</td>
<td>30.90%</td>
<td>5.50%</td>
<td>14.50%</td>
<td>30.90%</td>
<td>18.20%</td>
</tr>
<tr>
<td>Print media</td>
<td>14.60%</td>
<td>4.20%</td>
<td>22.90%</td>
<td>43.80%</td>
<td>14.60%</td>
</tr>
<tr>
<td>Shows/exhibitions</td>
<td>12.70%</td>
<td>12.70%</td>
<td>18.60%</td>
<td>43.10%</td>
<td>12.70%</td>
</tr>
<tr>
<td>Personal contacts</td>
<td>8.50%</td>
<td>10.60%</td>
<td>20.20%</td>
<td>47.90%</td>
<td>12.80%</td>
</tr>
</tbody>
</table>

Among those who responded, the situation was tied between those who rated radio as not influencing choice of source of finance at all (30.90%), and those who rated radio as influencing finance to a great extent (30.90%). Majority of the respondents rated the print media as influencing choice of source of finance to a great extent followed by those who rated these media to a moderate extent (see table 4.16).

Exhibitions and shows largely influenced choice of source of entrepreneurial finance to a great extent. Personal contacts mostly influenced choice of source of entrepreneurial finance to a great extent with a significant number also influencing issues to a moderate extent.

Table 4.17: Mean Values of Information Sources on Choice of Source of Finance

<table>
<thead>
<tr>
<th>Information Sources</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local radio stations effect</td>
<td>3.00</td>
<td>1.540</td>
</tr>
<tr>
<td>Local FI, exhibitions &amp; shows</td>
<td>3.30</td>
<td>1.225</td>
</tr>
<tr>
<td>Newspapers/magazines and journals</td>
<td>3.40</td>
<td>1.233</td>
</tr>
<tr>
<td>Personal enquiries</td>
<td>3.41</td>
<td>1.168</td>
</tr>
<tr>
<td>Valid N (list wise)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The overall mean values indicate the personal contacts most influenced search for entrepreneurial finance (at a moderate extent) with the highest mean value among the four options under investigation (see table 4.17).

Table 4.18: Reasons for Choosing Current Avenues of Entrepreneurial Finance

<table>
<thead>
<tr>
<th></th>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Needed finances</td>
<td>44.50%</td>
<td>55.50%</td>
</tr>
<tr>
<td>Personal contacts</td>
<td>45.90%</td>
<td>54.10%</td>
</tr>
<tr>
<td>Shows &amp; exhibitions</td>
<td>64.40%</td>
<td>35.60%</td>
</tr>
<tr>
<td>Radio stations</td>
<td>77.40%</td>
<td>22.60%</td>
</tr>
<tr>
<td>Print media</td>
<td>86.30%</td>
<td>13.70%</td>
</tr>
</tbody>
</table>

As shown in table 4.18 above majority of respondents (55.50%) chose to acquire finances since the business needed finances and they had information on where to obtain these finances. Personal contacts were the second most influential sources of information on funding availability (54.10%), followed by local financial institutions, shows and exhibitions, local radio stations and, lastly, newspapers, magazines and journals. Persons who cited personal contacts as influencers were roughly equal in proportions to those that did not see these as reasons for choosing current funding sources.
Table 4.19: Extent of Influence on Information Availability on Entrepreneurial Finance

<table>
<thead>
<tr>
<th>Influence on Information Availability</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Extent</td>
<td>73</td>
<td>32.4</td>
</tr>
<tr>
<td>Small Extent</td>
<td>9</td>
<td>4.1</td>
</tr>
<tr>
<td>Moderate Extent</td>
<td>30</td>
<td>13.7</td>
</tr>
<tr>
<td>Great Extent</td>
<td>95</td>
<td>42.9</td>
</tr>
<tr>
<td>Greatest Extent</td>
<td>16</td>
<td>6.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>223</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The summary of table 4.19 above is that majority of the respondents were of the opinion that information availability influenced them to go for entrepreneurial finance to a great extent (42.90%). A significant number (32.4%) felt that information availability did not influence at all their choice of source of finance. Thus, it can be concluded that overall information availability influenced sources of entrepreneurial finance to a moderate extent (13.7%).

![Figure 4.7: Effect of Information Availability on Choice of source of Entrepreneurial Finance](image)

As shown in figure 4.7, significant number of entrepreneurs felt that information availability had the effect of improving access to finance. An equally important segment did not think that information availability was of any influence in terms of facilitating entrepreneurial financing. The mean of the distribution was 1.50 and
standard deviation of 0.765, implying that the overall perception was that information availability had no effect on choice of source of entrepreneurial finance.

4.5.3 The Effect of Purpose of Finance on Choice of Source of Entrepreneurial Finance

Most entrepreneurs were motivated to search for capital due to the need to satisfy capital requirements. These could have included working capital as well as capitalization required by legislation for those that were listed. Similarly, a relatively large percentage did not see these as key drivers of the need to close the funding gap. As shown in table 4.20, the issue of acquiring equipment as a cue to search for financing was a close one with 45.70% of the respondents replying in the affirmative and 54.30% in the negative.

Table 4.20: Purpose of Financing Effect on Sources of Financing

<table>
<thead>
<tr>
<th>Purpose of Financing</th>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working capital requirements</td>
<td>31.30%</td>
<td>68.70%</td>
</tr>
<tr>
<td>Acquiring equipments</td>
<td>54.30%</td>
<td>45.70%</td>
</tr>
<tr>
<td>Expansion</td>
<td>72.30%</td>
<td>27.70%</td>
</tr>
<tr>
<td>Any other purpose</td>
<td>73.30%</td>
<td>26.70%</td>
</tr>
</tbody>
</table>

For start-up and expanding SMEs, this may be a consideration. However, for mature SMEs, the issue may be only that of replacing equipment due to wear and tear or installing value-added capacity. Most respondents were not of the opinion that expansion could have motivated a search for finances.

Expansion, as seen earlier on examination of data regarding employee numbers and assets growth, may have been too small to sustain a need for additional financing.
These findings are consistent with the life cycle theory of firms that presupposes that different stages of a firm’s development necessitate different types of financing.

As seen in the literature, the pattern of financing will follow the life cycle theory of the firm. Importantly, as the firm grows and begins to generate revenues, external equity may become available. When the firm achieves profitability and some measure of stability, bank loans may become an option (Amidu, 2007). In this sense, bank financing were mainly availed for financing operations such as overdrafts.

Table 4.21: Extent of Influence of Purpose of Finance Aspects on Choice of source of Funds

<table>
<thead>
<tr>
<th></th>
<th>No extent</th>
<th>Small Extent</th>
<th>Moderate Extent</th>
<th>Great Extent</th>
<th>Greatest Extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working capital</td>
<td>1.90%</td>
<td>7.10%</td>
<td>21.40%</td>
<td>53.90%</td>
<td>15.60%</td>
</tr>
<tr>
<td>requirements</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Acquiring equipments</td>
<td>1.00%</td>
<td>9.00%</td>
<td>26.00%</td>
<td>51.00%</td>
<td>13.00%</td>
</tr>
<tr>
<td>Expansion</td>
<td>9.30%</td>
<td>6.70%</td>
<td>14.70%</td>
<td>48.00%</td>
<td>21.30%</td>
</tr>
</tbody>
</table>

From table 4.21, working capital requirements influenced choicer of funds to a great extent (53.90%) as rated by most of the respondents, followed by those who rated its influence to a moderate extent (21.40%). Most of the respondents rated expansion as influencing choice of source of funds to a great extent (48.00%), followed by a significant number who rated expansion as having influenced choice to the greatest extent as rated. The majority did not have any other purposes that influenced choice of source of financing.
Table 4.22: Overall Extent of Influence of Purpose Proxies on Choice of source of Finance

<table>
<thead>
<tr>
<th>Purpose of Finance</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working capital</td>
<td>3.74</td>
<td>0.877</td>
</tr>
<tr>
<td>Acquiring equipment</td>
<td>3.66</td>
<td>0.855</td>
</tr>
<tr>
<td>Expansion</td>
<td>3.65</td>
<td>1.168</td>
</tr>
</tbody>
</table>

From the table 4.22 above, in the mean values, we see that working capital needs exerted the greatest level of influence on entrepreneurs search for finance, with the highest mean value of 3.74. Also, the low standard deviation of 0.877 indicated a high clustering around the mean of the distribution. This implies that there was close agreement among the respondents as to the efficacy of working capital as a key driver in influencing the choice of source of entrepreneurial finance.

As seen from the number of years during which most of the SMEs have been operating for (over 2 years), it can be concluded that their ability to grow and expand is largely constrained and that they have reached maturity. At this point, their capital needs will mainly be operating capital to finance their cash flows and maybe meet their financing obligations to suppliers and employees.

These observations are consistent with the observations by Higgins (2001), who observe the importance of short-term financing as a means of financing short-term needs especially where there is a mismatch between accounts payable and accounts receivable.
As seen in table 4.23 majority of the respondents (73.3%) felt that the purpose for which they sought financing did not influence or improve their ability to access the same. There were those who believed that their ability actually worsened as a consequence of this. A minority of 19.1% though felt that their position improved. Thus, the overall feeling was that purpose of finance had no effect on the entrepreneur’s choice of source of finance.

4.5.4 Effect of Cost of the Source of Finance of the Firm on Choice of Source of Entrepreneurial Finance

From table 4.24 interest rate incurred in obtaining finance was cited by the highest percentage of individuals (55.50%) as being the cost barrier most of them encountered in choosing finance. This was followed by travel cost and time at
28.50%, call cost and seminars and training. Sharing control with partners was the cost driver least encountered in choosing sources of finance (3.90%).

Interest rates have been on an upward trend and hit a critical point in 2011. High and rising interest rates have made the cost of financing especially prohibitive for SMEs in Kenya. The need to share control with partners in the firm attracted financing that was all debt, whereas training and seminars directed at the entrepreneurs had the highest influence on attracting the most equity in the financing structure of the entrepreneurial ventures.

Figure 4.8: Effect of Costs on Choice of source of Entrepreneurial Finance

Across the cost drivers, debt was more popular than equity as a source of finance with the lowest proportion of debt being above the 50% mark. Any other cost rate was rated by one respondent as leading to debt (loans) and by another as leading to equity in the form of personal savings (see figure 4.8).
Table 4.25: Extent of Influence of Given Cost Drivers (Percentages)

<table>
<thead>
<tr>
<th></th>
<th>No extent</th>
<th>Small extent</th>
<th>Moderate extent</th>
<th>Great extent</th>
<th>Greatest extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate effect</td>
<td>15.70</td>
<td>2.50</td>
<td>21.50</td>
<td>35.50</td>
<td>24.80</td>
</tr>
<tr>
<td>Call cost effect</td>
<td>36.20</td>
<td>6.40</td>
<td>21.30</td>
<td>29.80</td>
<td>6.40</td>
</tr>
<tr>
<td>Travel cost/time</td>
<td>19.40</td>
<td>19.40</td>
<td>33.90</td>
<td>21.00</td>
<td>6.50</td>
</tr>
<tr>
<td>Sharing profit</td>
<td>38.50</td>
<td>19.20</td>
<td>26.90</td>
<td>11.50</td>
<td>3.80</td>
</tr>
<tr>
<td>Seminars/training</td>
<td>20.90</td>
<td>20.90</td>
<td>34.90</td>
<td>18.60</td>
<td>4.70</td>
</tr>
<tr>
<td>Sharing control</td>
<td>43.50</td>
<td>8.70</td>
<td>26.10</td>
<td>13.00</td>
<td>8.70</td>
</tr>
<tr>
<td>Any other cost rate</td>
<td>33.30</td>
<td>16.70</td>
<td>41.70</td>
<td>0.00</td>
<td>8.30</td>
</tr>
</tbody>
</table>

From table 4.25 above sharing profits, sharing control and call cost were seen by majority of the respondents as not influencing at all. Interest as a cost driver was seen to influence choice of source of financing to a great extent. To give a better picture of where the overall opinions clustered, the mean values have been computed.

Table 4.26: Mean Values of the Influence of Selected Cost Drivers

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sharing profit</td>
<td>2.23</td>
<td>1.21</td>
</tr>
<tr>
<td>Any other</td>
<td>2.33</td>
<td>1.231</td>
</tr>
<tr>
<td>Sharing control</td>
<td>2.35</td>
<td>1.402</td>
</tr>
<tr>
<td>Call cost</td>
<td>2.64</td>
<td>1.405</td>
</tr>
<tr>
<td>Seminars/training</td>
<td>2.65</td>
<td>1.152</td>
</tr>
<tr>
<td>Travel cost/time</td>
<td>2.76</td>
<td>1.183</td>
</tr>
<tr>
<td><strong>Interest rate</strong></td>
<td><strong>3.51</strong></td>
<td><strong>1.324</strong></td>
</tr>
</tbody>
</table>

From the measures of central tendency above (table 4.26), interest rate was rated as influencing choice of source of finance to a great extent (3.51). Travel cost and time, attending seminars and training and call cost effect had an overall rating of a moderate extent with respect to their influence on entrepreneur’s choice of source of finance. The lowest rated cost driver with respect to choosing sources of financing was sharing profits with partners (2.23).
As seen, interest rates determine the level of debt assumed by the SMEs and were the most influential cost drivers. This may be attributable to the inefficiency and illiquid of the local financial markets, especially as SMEs are concerned. Travel cost and time and call cost together represent the search cost for entrepreneurial finance. These would be high, owing to information asymmetry costs that exist in the market, which eventually causes costs of finance to vary between the various sources of financing (Fama and French, 2005).

Figure 4.9: Influence of Cost on Sources of Finances
58% of the respondents were of the opinion that cost of finances influenced sources of entrepreneurial finances.

Table 4.27: Overall Rating of Cost as a Driver of Choice of source of Finance

<table>
<thead>
<tr>
<th>Rating of Cost</th>
<th>Frequencies</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Extent</td>
<td>65</td>
<td>31.1</td>
</tr>
<tr>
<td>Small Extent</td>
<td>27</td>
<td>12.9</td>
</tr>
<tr>
<td>Moderate Extent</td>
<td>31</td>
<td>14.8</td>
</tr>
<tr>
<td>Great Extent</td>
<td>76</td>
<td>36.4</td>
</tr>
<tr>
<td>Greatest Extent</td>
<td>10</td>
<td>4.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>209</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The majority of respondents rated overall costs as influencing choice of source of entrepreneurial finance to a great extent (36.4%). The opinions averaged at a
moderate extent as the extent to which costs, in general, influenced choice of source of financing. (see table 4.27)

Figure 4.10 Effect of Costs on Entrepreneurs Choice of source of Entrepreneurial Finance

As seen from figure 4.10 above, entrepreneurs felt that in general, cost of finance improved their choice of source of entrepreneurial finance (48.80%). A significant number also felt that this had no effect on their choice of sources of entrepreneurial finance (46.90%). A minority of (1.40%) felt that the cost of finance actually made their access worse while (2.90%) were indifferent to the effect of cost of finance in choosing source of finance
4.5.5 Choice of Sources of Entrepreneurial Finance

Table 4.28: Sources Applied For

<table>
<thead>
<tr>
<th>Sources (%)</th>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASCRAS</td>
<td>100.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Donor agencies</td>
<td>99.50</td>
<td>0.50</td>
</tr>
<tr>
<td>ROSCAS</td>
<td>99.10</td>
<td>0.90</td>
</tr>
<tr>
<td>Government agencies</td>
<td>99.10</td>
<td>0.90</td>
</tr>
<tr>
<td>Money keepers/savings collectors</td>
<td>98.60</td>
<td>1.40</td>
</tr>
<tr>
<td>MFI's</td>
<td>95.90</td>
<td>4.10</td>
</tr>
<tr>
<td>SACCOS</td>
<td>88.00</td>
<td>12.00</td>
</tr>
<tr>
<td>Family &amp; friends</td>
<td>87.50</td>
<td>12.50</td>
</tr>
<tr>
<td>Commercial banks</td>
<td>62.80</td>
<td>37.20</td>
</tr>
<tr>
<td>Personal savings</td>
<td>25.70</td>
<td>74.30</td>
</tr>
</tbody>
</table>

As seen in table 4.28 above, personal savings were the sources of finance most readily employed as a source of financing, followed by commercial banks, family and friends and SACCOS.

Table 4.29: Amount Obtained from Commercial Banks (in Kshs)

<table>
<thead>
<tr>
<th>Min</th>
<th>50</th>
<th>Percentile</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>with banks 1st yr</td>
<td>0</td>
<td>40000</td>
<td>202500</td>
<td>300000</td>
<td>14906.9</td>
</tr>
<tr>
<td>with banks 2nd yr</td>
<td>0</td>
<td>30000</td>
<td>110000</td>
<td>500000</td>
<td>17463.6</td>
</tr>
<tr>
<td>with banks 3rd yr</td>
<td>0</td>
<td>25000</td>
<td>63000</td>
<td>800000</td>
<td>17050.4</td>
</tr>
</tbody>
</table>

Roughly 25% of the respondents did not obtain any financing with commercial banks in the first three years of running their businesses. At the median level, borrowings from commercial banks for the 1st year stood at Kshs40,000, which decreased to Kshs30,000 and further down to Kshs25,000 in the 2nd and 3rd years respectively. This figures show an increasing trend by the 95th percentile.

This implies that most of the respondents restricted their borrowings in commercial banks to very small amounts. The high standard deviation figures are indicative of
this trend. However, the maximum amount borrowed demonstrates an increasing trend over the three years under investigation.

Table 4.30: Percentage Amount Obtained from SACCOs

<table>
<thead>
<tr>
<th></th>
<th>Min</th>
<th>75</th>
<th>90</th>
<th>95</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>% SACCOS 1st yr</td>
<td>0</td>
<td>15</td>
<td>72</td>
<td>65035</td>
<td>100000</td>
<td>3858.5</td>
<td>19609.1</td>
</tr>
<tr>
<td>% SACCOS 2nd yr</td>
<td>0</td>
<td>25</td>
<td>59</td>
<td>93</td>
<td>100</td>
<td>16.73</td>
<td>27.238</td>
</tr>
<tr>
<td>% SACCOS 3rd yr</td>
<td>0</td>
<td>33</td>
<td>79</td>
<td>100</td>
<td>100</td>
<td>18.65</td>
<td>31.291</td>
</tr>
</tbody>
</table>

From table 4.29 above, 50% of the respondents did not affect any borrowings from SACCOs in the first three years. Borrowings from SACCOs reflected when the number of SMEs reached the 75% mark. At this point, the percentage amounts borrowed were low but demonstrated an increasing trend as we move from year 1 to year 3 (15% to 33%).

These figures rose dramatically where the number of SMEs reached 90%, with percentage borrowings exceeding 70% for year 1 and year 3. It can be concluded that SACCOs were not the most popular option for financing among the entrepreneurs. This is supported by the low values for the mean, which decreased further moving to year 2 and Year 3.

ROSCAs were used as sources of finance by a very small number of the respondents. For these respondents, borrowings became significant at the median level, with percentage borrowings reaching 25%. Even then, the amounts borrowed were negligible for meaningful analysis. ASCRAs were not reported by any of the respondents as constituting a source of financing.

In microfinance Institutions borrowings were significant at the median value (50%), with the first year having a high of 38% but which reduced drastically in the next
two years. Up to 75% of the SMEs borrowed in excess of 50% from MFIs for year 1 and year 2.

Amounts borrowed by these respondents did not constitute a significant source of entrepreneurial finance. Percentage amount obtained with Government agencies in the first year is constant. Subsequent Government borrowings did not show any significant values that could form a basis for analysis in this study.

Despite its viability, borrowing from family and friends did not seem to be widely practised among the respondents. Borrowings demonstrated significant values at the median value, where up to 30% was borrowed from Family and Friends. Roughly 90% of the respondent SMEs borrowed more than 50% from friends and family from year 1 through to year 3. The amounts borrowed, as shown by the mean values are dismally small. The maximum amount borrowed towards the third year dropped dramatically.

Percentage amount obtained with International donor agencies in the 1\textsuperscript{st} year, 2\textsuperscript{nd} and 3\textsuperscript{rd} year is constant. The amounts registered were negligible for purposes of conducting meaningful analysis. Percentage amount obtained with Money keepers and savings collectors in the 3\textsuperscript{rd} year is constant. In other years, percentage borrowings were low and not significant. Money keepers and savings collectors were not a popular source of borrowings.
4.5.6 Percentage Amount Obtained from Personal Savings

Table 4.31: Percentage from Savings

<table>
<thead>
<tr>
<th></th>
<th>Min</th>
<th>25</th>
<th>50</th>
<th>75</th>
<th>95</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>% Personal savings</td>
<td>10</td>
<td>58</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>6372</td>
<td>45128.53</td>
</tr>
<tr>
<td>1st yr</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Personal savings</td>
<td>10</td>
<td>60</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>590.17</td>
<td>4177.957</td>
</tr>
<tr>
<td>2nd yr</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% Personal savings</td>
<td>10</td>
<td>60</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>487.08</td>
<td>4053.811</td>
</tr>
<tr>
<td>3rd yr</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

From table 4.31 above the minimum percentage obtained from personal savings was 10%. About 25% of the SMEs utilized over 50% of their savings for financing the business. From the median level onwards, 100% of the personal savings were deployed by the SMEs. At all levels of the SMEs, personal savings came in handy in financing the ventures. These were small amounts, although about 5% of SMEs above the 90th percentile registered significant savings inputs.

4.5.7 Reasons for Not Getting All Required Financing from One Source

Reasons cited for not accessing all the financing from commercial banks included the cost of finance, the economic situation, inadequate information, information availability, lack of enough security, purpose of finance, size of the firm, and type of account. SACCOs were constrained in lending to these SMEs owing to limitations to do with amount in savings with the SACCOs, SACCOs interest rates, lack of enough security and the size of the firm. In the case of ROSCAs, size of the firm as an issue while MFIs gave the maximum that they could get.
Family was avoided since there was a tendency to induce dependency, and the subsequent need for independence. Money keepers and savings collectors were primarily avoided because the cost of borrowing was found to be very high. Recurrent expenditure, expenses, and lack of information were the limitations cited for not employing personal savings to the fullest extent (see table 4.32).

### 4.5.8 Rating and Recommendation of the Sources (Percentages)

Table 4.32: Rating and Recommendation

<table>
<thead>
<tr>
<th>Sources</th>
<th>very high</th>
<th>high</th>
<th>average</th>
<th>low</th>
<th>not recommended</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
<td>32.10</td>
<td>7.10</td>
<td>42.90</td>
<td>14.30</td>
<td>3.60</td>
</tr>
<tr>
<td>SACCOS</td>
<td>14.30</td>
<td>9.50</td>
<td>61.90</td>
<td>9.50</td>
<td>4.80</td>
</tr>
<tr>
<td>ROSCAS</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>100.00</td>
<td>0.00</td>
</tr>
<tr>
<td>ASCRAS</td>
<td>0.00</td>
<td>0.00</td>
<td>50.00</td>
<td>50.00</td>
<td>0.00</td>
</tr>
<tr>
<td>MFI's</td>
<td>0.00</td>
<td>12.50</td>
<td>75.00</td>
<td>0.00</td>
<td>12.50</td>
</tr>
<tr>
<td>Government agencies</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Family/friends</td>
<td>33.30</td>
<td>20.00</td>
<td>6.70</td>
<td>40.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Donor agencies</td>
<td>0.00</td>
<td>50.00</td>
<td>50.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Money keepers/savings collectors</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>66.70</td>
<td>33.30</td>
</tr>
</tbody>
</table>
4.5.9 Mean Values

Table 4.33: Mean Values for Rating and Recommendation

<table>
<thead>
<tr>
<th>Sources</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>2.32</td>
<td>1.188</td>
</tr>
<tr>
<td>Donor agencies</td>
<td>2.50</td>
<td>0.707</td>
</tr>
<tr>
<td>Family/friends</td>
<td>2.53</td>
<td>1.356</td>
</tr>
<tr>
<td>SACCOs</td>
<td>2.81</td>
<td>0.981</td>
</tr>
<tr>
<td>MFI's</td>
<td>3.13</td>
<td>0.835</td>
</tr>
<tr>
<td>ASCRAs</td>
<td>3.50</td>
<td>0.707</td>
</tr>
<tr>
<td>ROSCAs</td>
<td>4.00</td>
<td></td>
</tr>
<tr>
<td>Money keepers/savings collectors</td>
<td>4.33</td>
<td>0.577</td>
</tr>
</tbody>
</table>

As in table 4.33 above commercial banks had the highest approval rating (rated “high”) while money keepers and savings collectors had the lowest approval rating (rated ‘low’) and the standard deviation values reflected close agreement among the respondents with regard to this issue. It can then be concluded that banks were the most popular options, followed by international donor agencies then family and friends.

Figure 4.11: Overall Rating of Choice of Sources of Entrepreneurial Finance
As shown in figure 4.11 above the majority of the respondents rated sources of entrepreneurial finance as being accessible to a moderate extent. A notable proportion also rated these sources as being accessible to an easy extent. The mean of the distribution was 2.56 and standard deviation of 0.875, implying that the respondents rated choice of source of financing at a moderate extent, with close agreement registered among the respondents.

Figure 4.12: Whether the Entrepreneurs Got the Required Amount of Funding

A majority of 57.50% asserted that they were able to access the required amount of financing while a significant proportion of 42.50% also reported inability to do the same (see figure 4.12)

Table 4.34: Overall rating of variables on influence to Access of Sources of Finances

<table>
<thead>
<tr>
<th>Effect of Purpose of Finance</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size</td>
<td>54.5</td>
</tr>
<tr>
<td>Information Availability</td>
<td>34.8</td>
</tr>
<tr>
<td>Purpose</td>
<td>8.0</td>
</tr>
<tr>
<td>Cost</td>
<td>2.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

As shown in 4.34 above, majority of the respondents identified size as the factor the most limited their choice of sources of financing. This was followed by information availability.
B Inferential Analysis Findings

This section examines the validity of the hypothesis formulate to test for any relationships among the study variables.

4.6 Hypothesis Testing

As a recap, the null hypotheses to be tested were the following: \( H_{01} \): Firm size does not affect choice of source of entrepreneurial finance; \( H_{02} \): Availability of information does not affect sources of entrepreneurial finance; \( H_{03} \): Cost of the source of finance does not influence choice of source of entrepreneurial finance; and \( H_{05} \): Purpose of finance does not influence choice of source of entrepreneurial finance.

4.6.1 Tests of Association between Entrepreneurial Competencies and Sources of Financing

The next level of analysis aimed at determining whether there was any association between various entrepreneur characteristics and the choice of various sources of financing. In order to accomplish this, the Chi Square Test of Independence which tests the association between two sets of categorical variables, were computed.

The entrepreneur competencies that were tested for any association with choice of various sources of entrepreneurial financing were gender (\( \chi^2=0.678, \text{df}=2, p=0.712 \)), status in the business (\( \chi^2=4.895, \text{df}=2, p=0.087 \)), religion (\( \chi^2=1.808, \text{df}=6, p=0.937 \)) and the entrepreneurs level of education (\( \chi^2=4.735, \text{df}=8, p=0.785 \)). The findings were not significant for any of these variables, implying that the entrepreneurial
competencies cited above did not influence choice of sources of entrepreneurial financing.

Only the output from the statistically significant findings was presented in the body of the discussion. In table 4.34 below, the findings generated from testing for the bivariate relationship between interest rate as a proxy for cost of financing and its relationship to the source of entrepreneurial financing are presented in full.

Initially, we obtain the case processing summary. ‘fmsource1’, ‘fmsource2’, and ‘fmsource3’ refer to sources of financing employed by the SMEs in year 1, year 2 and year 3 respectively (or 2009, 2010 and 2011 in our study). The case processing summary simply gives us the response rate per bivariate relationship under examination.

<table>
<thead>
<tr>
<th></th>
<th>Interest rate was used in obtaining finance</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>fmsource1</strong> Debt</td>
<td>8</td>
<td>14</td>
</tr>
<tr>
<td>% within fmsource1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% within Interest rate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>was used in obtaining</td>
<td></td>
<td></td>
</tr>
<tr>
<td>finance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% within Interest rate</td>
<td>36.4%</td>
<td>63.6%</td>
</tr>
<tr>
<td>was used in obtaining</td>
<td>15.1%</td>
<td>16.9%</td>
</tr>
<tr>
<td>finance</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td>38</td>
<td>34</td>
</tr>
<tr>
<td>% within fmsource1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% within Interest rate</td>
<td>52.8%</td>
<td>47.2%</td>
</tr>
<tr>
<td>was used in obtaining</td>
<td>71.7%</td>
<td>41.0%</td>
</tr>
<tr>
<td>finance</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Mixed</strong></td>
<td>7</td>
<td>35</td>
</tr>
<tr>
<td>% within fmsource1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% within Interest rate</td>
<td>16.7%</td>
<td>83.3%</td>
</tr>
<tr>
<td>was used in obtaining</td>
<td>13.2%</td>
<td>42.2%</td>
</tr>
<tr>
<td>finance</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>53</td>
<td>83</td>
</tr>
<tr>
<td>% within fmsource1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>% within Interest rate</td>
<td>39.0%</td>
<td>61.0%</td>
</tr>
<tr>
<td>was used in obtaining</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
<tr>
<td>finance</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Next, SPSS generates the familiar bivariate (contingency) table, including row and column percentages (Appendix 3). The row labeled ‘% within fmsource1’ represents the proportion of debt, equity or mixed financing in the source of financing for Year 1, 2 or 3.

Therefore, in this case, debt only had a proportion of 36.4% among the respondents for whom interest rates did not influence source or type of financing, whereas for those where interest rate was a driver, they accessed 63.6% debt financing only and so on. Table 4.36 below contains the chi-square score for the table (labeled Pearson chi-square), the table's degrees of freedom, and the p-value associated with the obtained chi-square score.

Table 4.36: Chi Square Test of Independence-proxies for cost, purpose and information availability on source of Finance.

<table>
<thead>
<tr>
<th></th>
<th>Pearson Chi-Square (χ²)</th>
<th>df</th>
<th>Asymp. Sig. (2-sided)</th>
</tr>
</thead>
<tbody>
<tr>
<td>interest rate vs source (year 1)</td>
<td>14.619^a</td>
<td>2</td>
<td>0.001</td>
</tr>
<tr>
<td>interest rate vs source (year 2)</td>
<td>26.885^a</td>
<td>2</td>
<td>&lt;0.001</td>
</tr>
<tr>
<td>interest rate vs source (year 3)</td>
<td>10.920^a</td>
<td>2</td>
<td>0.004</td>
</tr>
<tr>
<td>interest rate vs source (summary)</td>
<td>7.142(a)</td>
<td>2</td>
<td>0.028</td>
</tr>
<tr>
<td>Working Capital Requirements (Summary)</td>
<td>7.045^a</td>
<td>2</td>
<td>0.03</td>
</tr>
<tr>
<td>Working Capital Requirements (Summary)</td>
<td>7.157(a)</td>
<td>2</td>
<td>0.028</td>
</tr>
<tr>
<td>Acquiring Equipments vs Source (Year 1)</td>
<td>7.236^a</td>
<td>2</td>
<td>0.027</td>
</tr>
<tr>
<td>Acquiring Equipments vs Source (Year 2)</td>
<td>6.185^a</td>
<td>2</td>
<td>0.045</td>
</tr>
<tr>
<td>Acquiring Equipments versus Source (summary)</td>
<td>3.954(a)</td>
<td>2</td>
<td>0.138</td>
</tr>
<tr>
<td>Print Media versus Source (Year 1)</td>
<td>7.176^a</td>
<td>2</td>
<td>0.028</td>
</tr>
<tr>
<td>Print Media versus Source (Summary)</td>
<td>1.147(a)</td>
<td>2</td>
<td>0.564</td>
</tr>
<tr>
<td>Shows &amp; Exhibitions vs Source (Year 1)</td>
<td>6.919^a</td>
<td>2</td>
<td>0.031</td>
</tr>
<tr>
<td>Shows &amp; Exhibitions vs Source (Year 2)</td>
<td>7.214^a</td>
<td>2</td>
<td>0.027</td>
</tr>
<tr>
<td>Shows &amp; Exhibitions vs Source (Year 3)</td>
<td>11.208^a</td>
<td>2</td>
<td>0.004</td>
</tr>
<tr>
<td>Shows &amp; Exhibitions versus Source (Summary)</td>
<td>6.347^a</td>
<td>2</td>
<td>0.042</td>
</tr>
<tr>
<td>Personal Contacts versus Source (Year 2)</td>
<td>11.616^a</td>
<td>2</td>
<td>0.003</td>
</tr>
<tr>
<td>Personal Contacts versus Source (Summary)</td>
<td>4.802^a</td>
<td>2</td>
<td>0.091</td>
</tr>
</tbody>
</table>
Having described the basic output, the following sections will present only the results of the Chi-Square tests of Independence for the significant findings. The rest of the data will be annexed for reference purposes only. Source and choice of source of financing had a statistically significant association with the interest rate for year 1 ($\chi^2=14.619$, df =2, p=0.001), year 2 ($\chi^2=26.885$, df=2, p<0.001) and year 3 ($\chi^2=10.920$, df=2, p=0.004).

The overall relationship between interest rate and source of finance was also statistically significant. This implies that this association did not occur by chance but rather that there was a conscious effort by the entrepreneurs to assume those sources of financing that had favorable interest rates.

Choice of sources of funds in year 2 was statistically significant with the need to meet working capital requirements at the given level of significance ($\chi^2=7.045$, df =2, p=0.03). The summary relationship was also statistically significant ($\chi^2=7.157$, df =2, p=0.028). Overall, the need to meet working capital requirements had a statistically significant relation with choice of sources of financing. That this relationship may reflect the need for the entrepreneurs to finance such aspects as inventory, accounts receivable and accounts payable as the SMEs grew.

Source and choice of source of financing showed a statistically significant relationship with the need to acquire equipments in year 1 ($\chi^2=7.236$, df =2, p=0.027) and year 2 ($\chi^2=6.185$, df =2, p=0.045). This relationship was not observed in year 3, nor was the summary relationship statistically significant. This could be explained by the fact that at start-up, SMEs are in need of ‘seed’ capital to purchase equipment or goods to facilitate the business.
Entrepreneur’s choice regarding sources and types of funds had a statistically significant relationship with their use of the print media in Year 1 ($\chi^2=7.176$, df =2, p=0.028). This is most likely due to the search for start-up finances resulting in the examination of many sources of information. The summary statistic for the three years is not significant.

Choice of sources of finance demonstrates a statistically significant relationship with shows and exhibitions in year 1 ($\chi^2=6.919$, df =2, p=0.031), year 2 ($\chi^2=7.214$, df =2, p=0.027) and year 3 ($\chi^2=11.208$, df =2, p=0.004). The overall relationship between choice of sources of financing and shows and exhibitions was statistically significant ($\chi^2=6.347$, df =2, p=0.042). The conclusion is that shows and exhibitions due influence source chosen through providing objectively verifiable information and helping overcome investor fears and bias relating to these different sources of financing.

Choice of sources of financing had a statistically significant relationship with personal contacts over year 2 ($\chi^2=11.616$, df =2, p=0.003). The overall relationship for the three years was not statistically significant. These contacts may have been important in year 2 since the entrepreneurs felt that, as their businesses grew, they needed to obtain information on additional sources of financing.

Prior to choosing the test, Levene’s test for equality of variances was considered. Equal variances option was taken. Levene’s test assesses the assumption that the variances of the populations from which the different samples are drawn are equal. It tests the null hypothesis that the population variances are equal (called homogeneity of variance). If the resulting p-value of Levene’s test is less than some critical value
(typically 0.05), the obtained differences in sample variances are unlikely to have occurred by chance.

In this case, \( p=0.895 \) for equity while \( p=0.257 \) for debt sources, both of which exceed the critical value of 0.05 and hence, any differences among the variances in the source of financing are due to chance. Put differently, this means that the scores for entrepreneur’s choice of source of different types of financing have similar dispersions (spread).

Table 4.37: Independent Samples Test for Equality of Means of Debt/Equity Choice

<table>
<thead>
<tr>
<th></th>
<th>Levene's Test for Equality of Variances</th>
<th>t-test for Equality of Means</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>F</td>
<td>Sig.</td>
</tr>
<tr>
<td>Equity</td>
<td>.017</td>
<td>.985</td>
</tr>
<tr>
<td>Equal variances assumed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debts</td>
<td>1.296</td>
<td>.257</td>
</tr>
<tr>
<td>Equal variances assumed</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In the case of equity (see table 4.37), the value is 0.704 while that for debt is 0.006. Since that for equity is greater than the critical value, then the finding is not significant. We can then conclude that the independent samples T-test failed to reveal a statistically reliable difference between the mean numbers of entrepreneurs seeking equity financing and choice of source of equity financing. Similarly, the finding for debt reveals a statistically significant relationship between the mean numbers of entrepreneurs seeking debt financing and choice of debt financing.
4.6.2 Logistic Regression Model of the Predictors of Finance Choice

In the logistic regression model that was adopted earlier, y, the dependent variable, was taken to represent the possibility that the entrepreneur will choose equity over debt. The binary dependent variable had internal values where debt=0 and equity=1. The model predicted the probability of being in either of these categories. This implies that any considerations regarding the y-value revolved around the proportion of equity in the financing strategy.

The regression model estimates the coefficients of the independent variables in the regression equation that best predict the dependent variable, involving the independent variables of firm size, information availability, cost of the source of financing and the purpose of seeking financing as the independent variables.

Table 4.38: Results of the Binary Logistic Regression Model

<table>
<thead>
<tr>
<th>Variables in the Equation</th>
<th>B</th>
<th>S.E.</th>
<th>Wald</th>
<th>Df</th>
<th>Sig.</th>
<th>Exp(B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qe1.1.2(1)</td>
<td>-1.909</td>
<td>.689</td>
<td>7.679</td>
<td>1</td>
<td>.006</td>
<td>0.148</td>
</tr>
<tr>
<td>Qf1.1.2(1)</td>
<td>2.211</td>
<td>.765</td>
<td>8.352</td>
<td>1</td>
<td>.004</td>
<td>9.126</td>
</tr>
<tr>
<td>Qf1.1.5(1)</td>
<td>-2.534</td>
<td>1.262</td>
<td>4.028</td>
<td>1</td>
<td>.045</td>
<td>0.079</td>
</tr>
<tr>
<td>Constant</td>
<td>3.011</td>
<td>1.263</td>
<td>5.684</td>
<td>1</td>
<td>.017</td>
<td>20.298</td>
</tr>
</tbody>
</table>

From the table 4.38 above the findings generated from the last step of the study, call cost (Qf1.1.2(1)), acquiring equipments (Qe1.1.2(1)), and attending seminars and training (Qf1.1.5(1)) had beta coefficients that were significant in relation to the proportion of equity deployed in the financing mix. This first part of the regression model may be summarized as:

\[ \text{Logit} \left( p' \right) = 3.011 - 2.534Qf1.1.5 \left( 1 \right) + 2.211Qf1.1.2 \left( 1 \right) - 1.909Qe1.1.2 \left( 1 \right) \]
From the above goodness of fit equation, the values of the coefficients indicate the magnitude and direction of the influence of the given independent variables on the proportion of equity employed in the financing mix. The coefficients give us the change in the proportion of equity in the financing mix given a unit change in each of the three predictor variables.

It can be safely concluded that non-attendance of seminars and training decreases the likelihood of choosing equity by a factor of 2.534. Similarly, the non-acquisition of equipment decreases the likelihood to choosing equity by a factor of 1.909. Conversely, this could be interpreted to imply that attending seminars and training and acquiring equipments were associated with higher levels of debt compared to equity.

Similarly, not incurring any call cost had a positive impact on the likelihood that equity was used in greater proportion to debt by a factor of 2.211. Among the proxies for information availability, cost of financing and purpose of financing, these three independent variables were found to be related in the manner shown, to the proportion of equity employed in the financing mix.

In another sense, this finding could be interpreted to imply that call cost (or calling), lowers the information asymmetry inherent in debt financing, enabling the entrepreneur to make informed choices, and thus encouraging the uptake of more debt compared to equity.

The Exp (B) column presents the extent to which raising the corresponding measure by one unit influences the odds ratio. We can interpret Exp (B) in terms of the change in odds. The decision rule is, if the value exceeds 1 then the odds of an
outcome occurring increase; if the value is less than 1, any increase in the predictor leads to a drop in the odds of the outcome occurring.

For example, the Exp (B) value associated with call cost is 9.126. Hence when call cost is raised by one unit (one shilling) the odds ratio is 9.126 times as large and therefore entrepreneurs are 9.126 more times likely to choose equity financing.

The Exp (B) value associated with acquiring equipments is 0.148. Hence when purpose of finance was to acquire equipment the odds ratio was 0.148 times less (as per the decision rule above) and therefore entrepreneurs are 0.148 less times likely to choose equity financing.

Similarly, the Exp (B) value associated with attending seminars and training was 0.079. Hence when the cost incurred due to entrepreneurs attending seminars and training increased by one unit, the odds ratio of choosing equity decreased by 0.079 times.

4.6.3 Sub-Models to Check for the Effect of the Moderating Variables

The analysis also entailed running sub-modes that were meant to find out whether moderating variables had any moderating effect of amplifying dependent and independent effect. The analysis did not fit a model to measure the actual moderating effect, but rather to determine whether and how, moderating variables amplified or reduced the strength of relationship between the dependent and predictor variables.

It was found that business status and gender did not have any moderating effect. Religion as a moderating variable had some moderating influence, but which did not
make the relationship between the dependent and predictor variables stronger. Among the various religions, the Pentecostal denomination was picked in the sub-models as having a moderating effect. The regression equation for the religion is:

$$\text{Logit}(p') = 21.203Qf^{1.1.2}(1)$$

The sub-model with regard to religion was interpreted with care, since religion may bias the findings depending on the strength of one’s convictions. In either case, high coefficient variables in a logistic regression model should be treated carefully. When the levels of education were checked for their moderating effect, it was found that tertiary and secondary levels of education had a moderating effect though it did not make the relationship the dependent variables and the predictors stronger.

Table 4.39: Moderation Effect of Education

<table>
<thead>
<tr>
<th>Level of Education</th>
<th>Regression Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>University</td>
<td>No model</td>
</tr>
<tr>
<td>Tertiary</td>
<td>Logit$(p) = 21.203 - 20.628Qe^{1.1.2}(1)$</td>
</tr>
<tr>
<td>Secondary</td>
<td>Logit$(p) = -0.288 + 21.491Qf^{1.1.2}(1)$</td>
</tr>
<tr>
<td>Primary</td>
<td>No model</td>
</tr>
</tbody>
</table>

The regression sub-models in table 4.39 above, only tertiary and secondary levels of education had any moderating influence on the relationship between the predictor and dependent variables. Tertiary education had a less likelihood of the entrepreneur choosing equity over debt whereas secondary education had the opposite effect. We can conclude that education has a lowering effect on the information asymmetry and therefore risk involved in debt financing.
4.7 Discussion of the Findings

Personal characteristics of the entrepreneur, namely, gender, status in the business, religion and level of education were not significant, implying that the entrepreneur’s competencies did not influence choice of sources of finance. This does not agree with Muhanna (2007) who identified education as one of the factors influencing the source of entrepreneurial finance. Mason and Harrison (2002) identified gender as a factor considered by financiers when funding a firm.

Choice of source of financing had a statistically significant association with interest rates and the need to meet working capital requirements. Koch and McDonald (2000) agreed with the findings of the study that equity sources are often preferable to a firm as they will usually be cheaper and easier to arrange at short notice. The latter relationship may reflect the need for the entrepreneurs to finance such aspects as inventory, accounts receivable and accounts payable as the SMEs grew.

Choice of source of financing showed a statistically significant relationship with the need to acquire equipments in the first year, explained by the fact that at start-up, SMEs are in need of ‘seed’ capital to purchase equipment or goods to facilitate the business. Amidu (2007) agreed with the study that the financial requirements of a firm are determined by the nature of the business, goods produced and technology used.

Entrepreneur’s choice regarding sources and types of funds had a statistically significant relationship with their use of the print media in the first year. This is in agreement with Kolari(1994) who argues that entrepreneurial firms need to circumvent the problem of asymmetric information so as to get the right kind of
finance. This is most likely due to the search for start-up finances resulting in the examination of many sources of information.

Choice of source of finance demonstrated a statistically significant relationship with shows and exhibitions and personal contacts (the latter in the second year only). The conclusion was that shows and exhibitions influence source chosen through providing objectively verifiable information and helping overcome investor fears and bias relating to these different sources of financing. Personal contacts may have been important since the entrepreneurs felt that, as their businesses grew, they needed to obtain information on additional sources of financing.

In the test for equality of means, only debt revealed a statistically significant relationship between the mean numbers of entrepreneurs seeking debt financing and choice of debt financing. This led us to make the conclusion that selected sources of debt financing were a conscious choice on the part of the entrepreneur. Call cost, acquiring equipments and attending seminars and training had beta coefficients that were significant in relation to the proportion of equity deployed in the financing mix.

It was safely concluded that non-attendance of seminars and training and the non-acquisition of equipment decreased the likelihood to choosing equity. Conversely, this was interpreted to imply that attending seminars and training and acquiring equipments were associated with higher levels of debt compared to equity. Similarly, not incurring any call cost had a positive impact on the likelihood that equity was used in greater proportion to debt.
Religion had some moderating influence, but which did not make the relationship between the dependent and predictor variables stronger. Among the various religions, the Pentecostal denomination was picked in the sub-models as having a moderating effect. Tertiary education had a less likelihood of the entrepreneur choosing equity over debt whereas secondary education had the opposite effect. We concluded that education has a lowering effect on the information asymmetry and therefore risk involved in debt financing.

Size of the firm was found to have no significant relation with the choice of source of entrepreneurial finance. This contradicts Pretorius (2007) and Gregory et al. (2005) who found size of firm was a major factor considered by financiers in lending.

4.8 Chapter Summary

The study findings have enabled the researcher to isolate independent and moderating variables that affect the choice of source of entrepreneurial financing. The analysis deployed descriptive and inferential statistics to facilitate the study findings. Among the independent variables, key influencers were interest rates, the need to meet working capital requirements, the need to acquire equipments, shows and exhibitions and personal contacts (the latter in the second year only). Among the moderating variables, religion and level of education captured as influencing the relationship between the predictor and predicted variables.
CHAPTER FIVE

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary, conclusions and recommendations of the study. The general objective was to assess the determinants of sources of entrepreneurial finance for SMEs in Thika district.

5.2 Summary of Findings

This section presents a summary of the findings.

5.2.1 To Evaluate the Effect of Firm Size and Choice of source of Entrepreneurial Finance

From the descriptive analysis on issues revolving around firm size and choice of source of financing, several findings emerge. All the proxies that represented size except ‘profit’ were considered neutral. These were number of employees, age of business, annual average sales turnover, and expansion of the business.

In the case of profit, the respondents registered general agreement in that gross profit influenced where the firm got its finances. Business size in general influenced entrepreneur’s decision on where to apply for entrepreneurial financing to a moderate extent. Again, respondents generally shared the opinion that size of the firm improved their choice of source of entrepreneurial finance.

5.2.2 Hypothesis Testing-Firm Size and Choice of source of Entrepreneurial Finance

In relation to firm size and growth, the null hypothesis was as below:
The implication of the null hypothesis is that the distribution of the data relating to the choice of source of entrepreneurial finance for SMEs of different sizes is the same. The alternative hypothesis would be that these distributions are different. Pearson’s Chi Square did not reveal any statistically significant correlations between firm size and SME ability to access sources of financing.

The multiple logistic regression model also did not yield any relationship between these two variables. The study thus failed to reject the null hypothesis $H_{01}$. It was therefore concluded that firm size had no effect on the entrepreneur’s choice of source of entrepreneurial financing.

5.2.3 The Effect of Information Availability and Choice Entrepreneurial Finance

The majority of the respondents did not view electronic media and print media in form of local radio stations and newspapers/magazines as a source of information on sources of entrepreneurial finance. There were also mixed responses regarding the issue of local exhibitions and shows and personal contacts as sources of information. Significant proportions give varied opinions on both sides of the ‘yes’ and ‘no’ divide.

Local radio as a source of information resulted in the entrepreneurs accessing more debt (commercial banks) than equity in the form of SACCOs and personal savings. Print media mainly led entrepreneurs to sources of debt predominantly banks. Local shows and exhibitions mainly led to a majority of debt sources (bank borrowings) and a minority of equity sources such as SACCOs.
Personal contacts led entrepreneurs to not so dissimilar proportions of debt in form of bank borrowings and equity in form of SACCOs and savings. Personal enquiries were by far the source of information that led entrepreneurs to the highest source of equity financing compared to the others. The other forms of advertising were paid forms that are more attractive to issuers of debt financing and are thus liable to attract these individuals.

Overall response rate analysis regarding the efficacy of information sources revealed that personal contacts were the most highly rated by the entrepreneurs as influencing the search for entrepreneurial finance, followed by print media in form of newspapers and magazines, then local FIs, exhibitions and shows and local radio stations which actually tied.

Most entrepreneurs cited a need for finances as a reason for accessing current sources of financing. This need arose as a consequence of business growth, resulting in a need for additional sources of finance to finance business operations. Regarding the overall opinion of the respondents on the efficacy of information availability in influencing choice of source of financing, it can be concluded that overall information availability influenced sources of entrepreneurial finance to a moderate extent. Among the entrepreneurs, the overall perception was that information availability had little or no effect on choice of source of entrepreneurial finance.

5.2.4 Hypothesis Testing: Information Availability and Choice of source of Entrepreneurial Finance

$H_0$: Availability of information does not affect choice of source of entrepreneurial finance
In terms of choice of source of finance, the implication posed by the null hypothesis is that the distributions data relating to choice of source of entrepreneurial finance are the same for all SMEs regardless of their ability to obtain market information with regard to sources of financing. Among the sources of information selected, the print media chosen showed a statistically significant relationship in year 1, meaning that newspapers and magazines influenced the choice of source of financing in year 1.

On the other hand, shows and exhibitions demonstrated a significant relationship for the entire period under consideration. Personal contacts demonstrated a statistically significant relationship only in year 2. In the logit regression model, when the proxies for information availability were examined stepwise, none showed a predictive ability in relation to the proportion of equity deployed in the financing mix.

Given the significant associations revealed by shows and exhibitions and personal contacts, the study rejected the null hypothesis $H_{02}$. Consequently, the study accepted the alternative hypothesis, $H_{12}$, that availability of information affects choice of source of entrepreneurial finance.

5.2.5 The Effect of Cost of the Source of Financing of the Firm on Choice of source of Entrepreneurial Finance

Interest rate incurred in obtaining finance was the cost barrier most often in accessing finance. This was followed by travel cost and time, call cost, seminars and training and lastly, sharing control with partners. Regarding sources of financing attracted by the various cost drivers, the need to share control with partners in the
firm attracted financing that was all debt, whereas training and seminars directed at the entrepreneurs had the highest influence on attracting the most equity in the financing structure of the entrepreneurial ventures.

Across the cost drivers, debt was more popular than equity as a source of finance. Among the cost drivers, interest rate was the most influential, followed by travel cost and time, attending seminars and training and call cost, sharing control and sharing profits in that order. Interest rates determined the level of debt assumed by the SMEs and were the most influential cost drivers. This was attributed to the inefficiency and illiquidity of the local financial markets, especially as SMEs are concerned.

Travel cost and time, attending seminars and training and call cost all represented search costs that may be high owing to high levels of information asymmetry in the local market. Costs of financing, in general, were thought to influence choice of source of financing to a moderate extent and the overall perception of the entrepreneurs was that overall cost of finance had no effect on their ability to access sources of financing.

5.2.6 Hypothesis Testing: Cost of finance and Choice of source of Entrepreneurial Finance

\( H_0 \): Cost of the source of finance does not influence choice of source of entrepreneurial finance

The implication here is that the distributions of the data relating to the cost of financing were similar for all the SMEs irrespective of the actual cost of the different sources of entrepreneurial finance. Pearson Chi Square tests showed that
interest rates had a significant relationship with the source and choice of source of finance for the entire period under investigation. Therefore interest rates were an influence in deciding the source and choice of source of financing employed.

In the logit regression model, only attending seminars and training as a cost parameter showed any positive predictive ability with regard to the proportion of equity deployed in the financing mix. Thus, attending seminars and training increased the likelihood that entrepreneurs would deploy a higher proportion of equity in their financing mix.

Non-attendance of seminars and training had a negative likelihood on the probability that an entrepreneur employed a high proportion of equity in their financing mix. Again, with respect to cost as a driver, the study rejected the null hypothesis \( H_{03} \). Subsequently, the alternative hypothesis, \( H_{13} \), which states that cost of finance does affect choice of source of finance, was accepted.

5.2.7 The Effect of Purpose of Financing on Choice of source of Entrepreneurial Finance

Most entrepreneurs were motivated to search for capital due to the need to satisfy capital requirements. This was mainly that needed to finance inventory, accounts receivable and accounts payable or working capital. Additionally, they were also motivated for additional capital owing to increased legislative costs. Acquiring equipment was seen to be important to roughly half of the SMEs and it was thought that these would be for start-ups and those SMEs undergoing expansion.

However, for mature SMEs, the issue was thought to be only that of replacing equipment due to wear and tear or for installing value-added capacity. Most
respondents were not of the opinion that expansion could have motivated a significant search for finances. This was thought to be due to the fact that expansion was limited due to internal constraints.

In an analysis of the sources of financing emerged from the need to meet working capital requirements, equity was the most popular source accessed. Although the need to acquire equipment led to higher levels of equity funding, the proportion of debt was also very significant. Expansion led to higher proportions of debt compared to equity, but the latter was very significant.

Further summary analysis revealed that among the proxies for purpose of finance, working capital had the highest level of influence on choice of source of finance, followed by the need to acquire equipment and finally, expansion. Overall, purpose of finance was thought to influence choice of source of entrepreneurial finance to a moderate extent and the entrepreneur’s perception was that it had no effect on the entrepreneur’s choice of source of finance.

5.2.8 Hypothesis Testing: Purpose of Financing and Choice of source of Entrepreneurial Finance

$H_{0}$: Purpose of finance does not influence choice of source of entrepreneurial finance.

The null hypothesis rejects any association between purpose of financing and the entrepreneur’s choice of source of entrepreneurial finance, implying the choice of sources of financing will have similar distributions irrespective of the purpose for which the funds were intended. From the Pearson’s Chi Square tests, the findings
with respect to working capital requirements and the need to acquire equipment were significant.

In the logit regression model, only acquiring equipments as a purpose of financing parameter showed any significant predictive ability with the proportion of equity in the financing mix. Non-acquisition of equipment had a negative likelihood on the probability that an entrepreneur employed equity in their financing mix. Again, with respect to purpose of financing as a driver, the study rejected the null hypothesis $H_0$. Subsequently, the study accepted the alternative hypothesis, $H_1$, that purpose of finance does influence the choice of source of entrepreneurial finance.

5.2.9 The Effect of Entrepreneurs Personal Characteristics on Choice of source of Entrepreneurial Finance

The analysis also entailed running sub-models that were meant to find out whether moderating variables had any moderating effect of amplifying dependent and independent effect. It was found that business status and gender did not have any moderating effect. Religion as a moderating variable had some moderating influence, but which did not make the relationship between the dependent and predictor variables stronger.

Among the various religions, the Pentecostal denomination was picked in the sub-models as having a moderating effect. When the levels of education were checked for their moderating effect, it was found that tertiary and secondary levels of education had a moderating effect though it did not make the relationship the dependent variables and the predictors stronger.
Only tertiary and secondary levels of education had any moderating influence on the relationship between the predictor and dependent variables. Tertiary education had a less likelihood of the entrepreneur choosing equity over debt whereas secondary education had the opposite effect. It was concluded that education has a lowering effect on the information asymmetry and therefore risk involved in debt financing. The studies also rejected the null hypothesis, H05 that proposed that entrepreneur’s personal characteristics, as identified by gender, business status, religion and level of education, do not affect the choice of source of entrepreneurial financing.

5.3 Conclusions

5.3.1 Firm Size and Growth on Choice of source of Entrepreneurial Finance

Firm size had no influence on the entrepreneur’s choice of debt or equity sources of financing. The conclusion that can be made here is that the SMEs were not constrained by size in their ability to access debt or equity. This is an encouraging thought, given that some entrepreneurs actually recommended the same.

In a few instances, their recommendations seemed to suggest that certain financiers do look at firm size, but these were not significant. Preliminary analysis suggested that profitability did have an influence on lenders perception, so it would help if the SMEs could enhance their profitability to tap into this link with source of financing.

5.3.2 Effect of Information Availability on Choice of source of Entrepreneurial Finance

Availability of information does affect sources of entrepreneurial finance, whether in form of debt or equity. Print media, such as newspapers and magazines, shows and exhibitions and personal contacts were the proxies most prominent. Information is
therefore considered important, and this can be attributed to its usefulness in overcoming information asymmetry challenges that so often result in an increase in the cost of funds.

5.3.3 Effect of Cost of the Source of Financing of the Firm on Choice of source of Entrepreneurial Finance

Cost of the source of finance does influence choice of source of entrepreneurial finance. The most significant cost drivers were interest rates and attending seminars and trainings. Cost as a driver has different aspects such as the direct cost of funds (interest rates), as well as the search costs associated with accessing these funds such as travel cost and time and the calling cost. The search costs were not significant, implying that entrepreneurs did not have to spend too much time and money on determining which sources of finance to access.

Attending seminars and training increased the entrepreneur’s knowledge of the workings of debt financing, and thus encouraged investors to prefer debt to equity in their financing mix. Seminars and trainings address the failings of lenders in not disseminating sufficient information regarding their lending products, thus overcoming borrower’s fears regarding the same.

5.3.4 Effect of Purpose of Financing on SMEs Ability to Access Capital

Purpose of finance does influence choice of source of entrepreneurial finance. Working capital requirements and the need to acquire equipment were the purposes that significantly influenced SME ability to access capital. Further, non-acquisition of equipment was found to discourage equity in the financing mix and to promote debt.
Other proxies, such as working capital also exerted some influence, albeit this was insignificant in this study. Acquisition of equipment tends to be a capital intensive undertaking, one which is better financed through debt rather than personal or public equity.

5.4 Recommendations of the Study

5.4.1 Recommendations by the Entrepreneurs

The below section provides the suggestions made by the entrepreneurs on how they as well as the government could improve choice of sources of entrepreneurial finance. Entrepreneurs had varied suggestions regarding how to improve choice of source of entrepreneurial finance.

These included the need to accumulate assets (real estate, goods and services) for collateral formation, reduce information asymmetry regarding financing sources, compliance with the law and adopt proper accounting practices such as the reporting standards and internal control systems established in the Generally Accepted Accounting Principles (GAAP).

Entrepreneur’s also cited the need for training seminars and workshops on financial literacy, the need to form economic groups such as ROSCAs, business diversification and emphasis on fast moving consumer goods. Proper management practices were emphasized that centered on discipline and diligence in day to day execution of business affairs.

Entrepreneurs also suggested the need to consult more with financial institutions such as banks and SACCOs, save more and keep themselves updated on current
business affairs through reading newspapers and business magazines. Finally, entrepreneurs recognized the need for healthy competition as an incentive to improve marketing of goods and services as well as reducing the cost of doing business such as lower operating costs, sourcing for lower interest rates and reduced licensing requirements.

5.4.2 Recommendations from a Policy Point of View

This study recommends that SMEs should focus on size in terms of increased profitability as a means of improving their ability to choice of sources of financing. Profit did have some influence on where an SME obtained finances although the findings were not significant in this study. By leveraging on profit, it is possible to convert this into a significant perspective that would attract funding.

Internal efficiencies must be embraced to minimize waste in order to increase operating costs and reduce profitability. In this way, SMEs, irrespective of size, are able to optimize their financial and operating ratios which enable them to support higher levels of debt and equity funding.

Information sources such as radio are very versatile sources because of their low cost and wide reach, in the mass media. Equally, local financial institutions, shows and exhibitions are also a channel that can be promoted for purposes of providing information on the viability and availability of different sources of financing. These channels, although used, were not statistically significantly utilized.

This state of affairs can be altered through strategic advertising using radio and shows. Exhibitions are especially versatile as they offer a means of personal selling, a powerful medium for promoting risky products such as debt. Radio can be
exploited for its wide reach and appeal. Other information sources not cited in this study such as Internet may also be used.

According to the analysis and the entrepreneurs own submissions, interest rate costs are the single largest cost of financing that the entrepreneurs have to bear. Although it is difficult to unilaterally reduce interest rates given the market forces in question, entrepreneurs could seek alternative sources.

For instance, loans are inconvenient for financing SMEs since they are issued in fixed tenure and amounts. Overdrafts would be a better alternative since they offer entrepreneurs flexibility of utilization, and entrepreneurs pay only for what they utilize.

Other more affordable sources of financing, such as family and friends, or partnerships and groups, could be emphasized. Entrepreneurs could also be educated on ways of lowering their costs through creative and legal accounting practices, e.g. exploiting the interest tax benefits that come with debt financing.

For SMEs to use purpose of financing as a winning tool, it is imperative that they objectivize their strategic planning process and adopt formal tools and procedures in doing so. An informal approach to strategic planning tends to be viewed with suspicion by potential lenders more so debt-issuers.

A formal strategic planning process lays out the SMEs mission and vision, and operationalizes the company’s strategy as well as having effective strategic control tools. This enables such SMEs to score higher in the credit scoring tools and also act as risk mitigants where consideration for debt arises.
Government was thought to be a potential facilitator in many ways. These included increasing choice of sources of debt such as banks and SACCOs, advancing soft loans to business owners, as a facilitator for educative forums, seminars and education camps. Others included acting as the regulatory authority in the sector with roles such as ensuring fair play, transparency, accountability and licensing of new players and designing policies that enable favorable working of the sector.

The entrepreneurs also felt that Government should reduce the cost of doing business through increased subsidies and developing alternative low cost channels for funds distribution to SMEs. Also, Government had the power to reduce tax rates and streamline licensing, and take action against entrepreneurial financiers found exploiting the entrepreneur. Bilateral and multilateral trading ties with more friendly countries were thought to also favorable in broadening the market available to SME goods and services.

Government, through bulletins and publications, could also disseminate timely/relevant information in regard to the investment atmosphere, thus empowering people in the field. Entrepreneurs also felt that collateral requirements were a major barrier to accessing loans and that this, along with the loan application process in general, also needed to be addressed. In order to facilitate the faster movement of goods and services, especially fresh produce, it was felt that there was a need to improve on transport system.

Entrepreneurs also felt that they needed to be consulted when policies were being formulated. Entrepreneurs encouraged that lenders should not consider business size when developing financing strategies and this was important given that size was one
of the parameters under consideration in this study. Again, they felt that Government should intervene to help reduce the cost of funds.

5.5 Areas for Further Research

This study was restricted to four independent variables these being firm size, information availability, cost of financing and purpose of financing. There are other independent variables that may affect the observed findings but which are not accounted for in the model.

Such independent variables include age of the firm, location of the business and certain qualitative aspects such as brand equity, to name a few. Similarly, there are other moderating variables other than those mentioned, which may influence the relationship between the independent and dependent variables.

Such entrepreneurial competencies may include the level and quality of guidance, and entrepreneur’s experience. These may also need to be accounted for in future research. Also, there are different reasons why entrepreneurs may get funds in say, banks, and not in MFIs or other lending institutions. Future studies could examine in detail what factors affect individual lending institutions in making their lending decisions.
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APPENDIX 1: QUESTIONNAIRE FOR SME

Section A: Entrepreneurs bio-data

i. Name……………..
ii. Contact…………

1. For how long have you been in the firm? ______  
2. Gender of the entrepreneur. Male □ Female □  
4. Religion of the entrepreneur. Anglican □ Catholic □ Pentecostal □ □ Muslim □ Others  
5. Level of education. University □ Tertiary □ Secondary □ Primary □ Less primary □  
6. Have you ever applied any form of finance where gender was a qualification? Yes □ No □  
   If yes, indicate the source__________________________________  
7. Have you ever applied finances where the lender required a certain level of education to qualify? Yes □ No □  
8. When you applied money for the firm, did they ask what your status in the business is?  
   Yes □ No □  
9. Have you ever applied money from a lender who required that you belong to a particular religion? Yes □ No □  

Section B: SME Bio-Data

1. Firm location______________  
2. Number of employees in your firm. 2011 _____ 2010 _____ 2009 _____  
3. Year of registration of the firm. ________  
4. Year the firm started operating. ________  
5. Listed in the Nairobi Stock exchange? Yes □ No □  
6. Ownership a) Foreign □ Local □ Total % □  
   b) Public □ Private □ Total % □  
   c) Individual □ Groups □ Total % □
7. Number of directors.  


9. Indicate the major types or sources of funds employed by your firm

<table>
<thead>
<tr>
<th>% Source of funds</th>
<th>2011</th>
<th>2010</th>
<th>2009</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>100%</td>
</tr>
</tbody>
</table>

Total 100% 100% 100%

Section C: Size of the firm

1. Please fill in the size parameters given below:
   a) How many employees does the firm have other than the owner? __________
   b) Give the estimate in Ksh of the assets of the firm______________
   c) For the last 5 years indicate on average the monthly gross profit of the firm__________
   d) For how long has the business been in operation? _________________
   e) Indicate how many branches the firm has if any __________
   f) In which category does your firm fit? service ☐ Trade ☐ Manufacturing ☐ (tick all which apply)

2. Looking at the above parameter tick the extent to which you agree with the following statements. Use the scale given below
SA-strongly agree, A-agree, N-neutral, D-disagree, SD-strongly disagree

<table>
<thead>
<tr>
<th>Size Parameters</th>
<th>SA</th>
<th>A</th>
<th>N</th>
<th>D</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. The number of employees did not influence where you obtained your finance.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. Gross profit influenced where you got your finance.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. The age of the business determined where you got your finance.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d. Annual average turnover in sales of the business did not influence the source of entrepreneurial finance.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>e. Expansion of the business in terms of branches influenced where you obtained finance.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>f. Any other (please indicate and tick)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. Which of the following describes the influence of size of your business on where you applied for entrepreneurial finance?

   i. No extent at all
   ii. Small extent
   iii. Moderate extent
   iv. Great extent
   v. Greatest extent

4. Which of the following best describes the effect of size on your choice of source of entrepreneurial finance in the source applied?

   i. Improved
   ii. No effect/ remained the same
   iii. Worsened
   iv. Do not know

Section D: Information availability

1. Please tick where appropriate in the table using the scale given below
**NE- No Extent at all, SE-Small Extent, ME-Moderate Extent, GE-Great Extent, GEX-Greatest Extent**

<table>
<thead>
<tr>
<th>Sources of financial Information</th>
<th>Which Source of information prompted search for finance</th>
<th>Which source did it lead you to? Indicate</th>
<th>Rating the effect of information availability on choice of source of funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Local Radio stations</td>
<td></td>
<td></td>
<td>NE SE ME GE GEX</td>
</tr>
<tr>
<td>2 Newspapers / Magazines and journals</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Local financial Institutions, exhibitions and shows</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Personal enquiries from other entrepreneurs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Any other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. Please tick where appropriate

   i. I choose to acquire finances from the above source because the enterprise required finance and I was informed on where to get it. Yes ☐ No ☐

   ii. I got information through local radio stations that there are available finances to boost enterprises. Yes ☐ No ☐

   iii. I read from magazines and newspapers on this finance and decided to go for it. Yes ☐ No ☐

   iv. Through local shows and exhibition I was convinced of the suitability of the finance by the lender. Yes ☐ No ☐

   v. I talked to some friends and colleagues and those who have in business and they informed me the best source of finance. Yes ☐ No ☐

3. Which of the following describes the extent to which information availability influenced you to go for the entrepreneurial finance?

   i. No extent at all ☐

   ii. Small extent ☐

   iii. Moderate extent ☐

   iv. Great extent ☐

   v. Greatest extent ☐
4. Which one of the following describes the effect of information availability on your choice of source of entrepreneurial finance?

   i. Improved
   ii. No effect/ remained the same
   iii. Worsened
   iv. Do not know

Section E: Purpose of finance

1. Please tick appropriately in the table using the scale given below
   NE- No Extent at all, SE-Small Extent, ME-Moderate Extent, GE-Great Extent, GEX-Greatest Extent

<table>
<thead>
<tr>
<th>List of purpose of finance</th>
<th>Purpose prompting search for finance</th>
<th>The source of finance it led you to and whether obtained, indicate</th>
<th>Rating effect of purpose on choice of source of funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Meeting working capital requirements</td>
<td></td>
<td></td>
<td>NE   SE   ME   GE   GEX</td>
</tr>
<tr>
<td>2 Acquiring Equipments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Expansion of the firm</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Any other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. Which of the following best describes the influence of purpose of finance on source of entrepreneurial finance above?

   i. No extent at all
   ii. Small extent
   iii. Moderate extent
   iv. Great extent
   v. Greatest extent
3. Which one of the following describes the effect of purpose of finance on your choice of source of entrepreneurial finance?

i. Improved
ii. No effect/ remained the same
iii. Worsened
iv. Do not know

Section F: Cost of finance

1. Please tick appropriately in the table using the scale given below Interest rates

<table>
<thead>
<tr>
<th>List of cost involved in obtaining finance</th>
<th>Tick the costs that you had to bear.</th>
<th>Which source of finance were you acquiring</th>
<th>Rating effect of cost on choice of source of funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate</td>
<td></td>
<td></td>
<td>NE  SE ME GE GEX</td>
</tr>
<tr>
<td>2. Call cost</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Travel cost and time</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Sharing profit with partners</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Attending seminars and training</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Sharing control with partners</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Any other cost</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. Did the cost of finance influence your decision on where to acquire your finance? Yes No

3. Which one of the following best describes the extent to which costs of finance influenced your the source of entrepreneurial finance above?

i. No extent at all
ii. Small extent
iii. Moderate extent
iv. Great extent
v. Greatest extent
5 Which one of the following describes the effect of costs of finance on your choice of source of entrepreneurial finance?

i. Improved
ii. No effect/ remained the same
iii. Worsened
iv. Do not know

Section G: Choice of sources of entrepreneurial finance

1. Please tick appropriately in the table using scale given below
   VH-Very High, H-High, A-Average, L-Low, NR-Not Recommended,

<table>
<thead>
<tr>
<th>Tick the entrepreneurial finance you applied for</th>
<th>Amount obtained in % for the last 3 funding</th>
<th>Reasons for not getting 100%</th>
<th>Rate the source and recommend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SACCOS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROSCAS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ASCRAS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MFI</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Government agencies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Family and friends</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>International donor agencies</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Money keepers and savings collectors</td>
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<tr>
<td>Personal savings</td>
<td></td>
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<tr>
<td>Others</td>
<td></td>
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<tr>
<td>Total</td>
<td>100%</td>
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</tbody>
</table>

2. How would you rate your choice of the sources above?

i. Unlimited access
ii. Easy access
iii. Moderate access
iv. Limited access
v. No access at all.

3. Did you get the required amount? Yes ☐ No ☐

4. If you did not access the source of finance you required, what was then limiting factor?
i. Size of the firm
ii. Information availability
iii. Purpose of finance
iv. Cost of finance
v. Any other

f. Indicate the increase in your finance for the last three years

<table>
<thead>
<tr>
<th>Amount of finance in ksh.)</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
</table>

Section H: Recommendations

1. What would you like to be done by entrepreneur to improve choice of source of entrepreneurial finance?
2. What would you like to be done by the government to improve choice of source of entrepreneurial finance?
APPENDIX 2: OUTPUT FROM INFERENTIAL STATISTICS

Part 2: Output from the Multiple Logistic Regression Analysis Stepwise  Forward Conditional Analysis

<table>
<thead>
<tr>
<th>Variables in the Equation</th>
<th>B</th>
<th>S.E.</th>
<th>Wald</th>
<th>Df</th>
<th>Sig.</th>
<th>Exp(B)</th>
</tr>
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<tbody>
<tr>
<td>Step 0</td>
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<td></td>
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<td>.242</td>
<td>26.220</td>
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<td>.000</td>
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<table>
<thead>
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<th>Wald</th>
<th>Df</th>
<th>Sig.</th>
<th>Exp(B)</th>
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<tbody>
<tr>
<td>Step 1&lt;sup&gt;a&lt;/sup&gt;</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Qf1.1.2(1)</td>
<td>1.245</td>
<td>.579</td>
<td>4.622</td>
<td>1</td>
<td>.032</td>
<td>3.474</td>
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<tr>
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<td>.504</td>
<td>.249</td>
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<td>.618</td>
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</table>

<table>
<thead>
<tr>
<th>Variables in the Equation</th>
<th>B</th>
<th>S.E.</th>
<th>Wald</th>
<th>Df</th>
<th>Sig.</th>
<th>Exp(B)</th>
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<tr>
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<td>.590</td>
<td>5.362</td>
<td>1</td>
<td>.021</td>
<td>.255</td>
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<td>Qf1.1.2(1)</td>
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<td>.648</td>
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<td>.011</td>
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<tr>
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<td>.580</td>
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<td>.179</td>
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<table>
<thead>
<tr>
<th>Variables in the Equation</th>
<th>B</th>
<th>S.E.</th>
<th>Wald</th>
<th>Df</th>
<th>Sig.</th>
<th>Exp(B)</th>
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<td>.004</td>
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a. Variable(s) entered on step 1: Qf1.1.2.
b. Variable(s) entered on step 2: Qe1.1.2.
c. Variable(s) entered on step 3: Qf1.1.5.
### Categorical Variables Codings

<table>
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<th>Parameter coding</th>
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<td>No</td>
<td>36</td>
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<td></td>
<td>Yes</td>
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<td>36</td>
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<td></td>
<td>Yes</td>
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<td>.000</td>
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<tr>
<td>Qd1.1.2 Newspapers/ magazines and journals as Source of financial information</td>
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<td>No</td>
<td>18</td>
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<tr>
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<td>Yes</td>
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<td>.000</td>
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<td>Qd1.1.4 Personal enquiries from other entrepreneurs as Source of financial information</td>
<td>No</td>
<td>20</td>
<td>1.000</td>
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<td></td>
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<td>17</td>
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</tr>
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<td></td>
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<td>Qe1.1.2 Acquiring Equipments prompted search for finance</td>
<td>No</td>
<td>17</td>
<td>1.000</td>
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<tr>
<td></td>
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<td>20</td>
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<td>Qe1.1.3 Expansion of the firm prompted search for finance</td>
<td>No</td>
<td>26</td>
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<td>11</td>
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<td>Qf1.1.5 Attending seminars and training was involved in obtaining finance</td>
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<tr>
<td></td>
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<td>Qf1.1.4 Sharing profit with partners was involved in obtaining finance</td>
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<td>33</td>
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<td></td>
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<tr>
<td>Qf1.1.3 Travel cost and time was involved in obtaining finance</td>
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<td>28</td>
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<td></td>
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<td>9</td>
<td>.000</td>
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<td><strong>Tertiary</strong></td>
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<td>Qf1.1.3 Travel cost and time was involved in obtaining finance</td>
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<table>
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<th>Secondary</th>
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<tr>
<td>Qd1.1.1 Local radio station as Source of financial information</td>
</tr>
<tr>
<td>Qd1.1.2 Newspapers/ magazines and journals as Source of financial information</td>
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<td>Qd1.1.3 Local financial institutions, exhibitions and shows as Source of financial information</td>
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</tr>
<tr>
<td>Qf1.1.3 Expansion of the firm prompted search for finance</td>
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<td>Qf1.1.4 Sharing profit with partners was involved in obtaining finance</td>
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<td>Qf1.1.3 Travel cost and time was involved in obtaining finance</td>
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<tr>
<td>Qf1.1.2 Call cost was involved in obtaining finance</td>
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<tr>
<td>Qf1.1.1 Interest rate was used in obtaining finance</td>
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