

# Effects of Funding Source on Growth of Small and Medium Enterprises in Kenya: A Case Study of Juja Town, Kiambu County

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**Abstract:** There are several funding sources utilized by SMEs which include bank loans, Sacco loans, Microfinance institutions, and personal savings, among others. The effects of these sources on the growth of SME vary. This paper explores the effects of Sacco Loan on the growth of SMEs within Juja town, Kiambu County, Kenya. Target population comprises of 60 SMEs within Juja town, and the desired sample size of 52 SMEs is used, Kathuri and Pals (1993). Due to homogeneity amongst the SMEs, cluster sampling is appropriate. The study employs descriptive research design because it portrays accurate responses from targeted owners and managers of SMEs within the target population. Primary data is collected using structured questionnaires and direct interviews. The relationship between the dependent variable (growth of the SMEs) and independent variables (Sacco loan) is determined using Pearson Correlation and descriptive statistics. The study established that source of funding significantly affects the growth of SMEs ( $p=0.05$ ). Further, it is evident that the Sacco loans harbors great potential of aiding the growth of the SMEs and the study, therefore, recommends that more effort should be directed towards making the Sacco loans available to the SMEs operators at various levels.

**Keywords:** Small and Medium Enterprise, Savings and Credit Cooperative Society, Funding Source.

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## 1. INTRODUCTION

Small and Medium Enterprises (SMEs) are a fundamental part of the economic fabric especially in developing countries of which Kenya is one of them. They play a crucial role in furthering growth, innovation and prosperity of citizens. Most policy makers, planners and academicians acknowledge that the future of a country's competitiveness and economic growth heavily depend on the private sector in which SMEs play a major role (Rutashobya, 2003). They are recognized as seedbed for indigenous entrepreneurship, which may lead to economic prosperity.

A crucial element in the growth of any SME is access to funding (Carpenter, 2001). Unfortunately, most SMEs are faced with many challenges in accessing funding. In developing countries, most SMEs rate access to funding as a major constraint. They may not access funding from local banks at all, or get less amount than they apply for due unfavorable lending conditions.

A number of studies have shown that financing is a greater obstacles for SMEs than it is for large firms, particularly in the developing world, and that access to finance adversely affect the growth of the SME sector more than that of large companies (Schiffer & Weder, 2001), (Beck *et al.*, 2005). Most studies by the World Bank show that access to funding by SMEs is perceived as one of the main obstacles to their growth. The international development community has listed SME access to funding as an important policy priority.

Savings and Credit Co-operative Societies (SACCOs) are part of the financial system in Kenya. SACCOs receive savings from members in form of shares or deposits and from this created pool; they serve the credit needs of members through personal loans. The principle underlying lending by SACCOs is that not every member will request for a loan at the same time (Ongore, 2001). SACCOs are not foreign to Africa. There existed indigenous savings associations known by

different names (“ekubi” in Ethiopia, “sanduki” in Sudan, “enusi in Nigeria, “chilimba” in Zambia and so on) but all of them consisted of simple organizations in which savings and credit were administered on rotating basis by the members. Examples of such organizations in Kenya include the women’s “mabati” or “makuti” groups. These groups meet at intervals (weekly, monthly and so on) and each of the members contribute a fixed amount.

Loans to members are granted for almost any productive purpose but the upper limit cannot presently exceed four times the members’ shares or deposits and with a maximum repayment period of 48 months. The security for loans is usually composed of the member’s own savings in addition to two or three guarantors whose considered shares and those of the members must exceed the amount of loan applied for. This is to ensure that in case of default, the loan can be recovered fully from the shares of the member and those of his/her guarantors (circular by Commissioner of Cooperatives, 1997). Repayment of loans is usually made by installments through salary deductions. The maximum rate of interest charged on loans is 1% per month on the outstanding balance, which translates into annual rate of 12% p.a. although a lower rate is allowable. Members can also repay outstanding loan in order to qualify for another loan or where the member has left the common bond of the society (Burnett, 1997).

According to Munyiri (2006), SACCOs which are started locally in the financial sectors of many countries, are more attractive to customers thus deeply entrenching themselves. In, they have solid bases of small saving accounts constituting a stable and relatively low-cost source of funding and low administrative costs (Branch, 2005). More so, SACCOs are able to advance loans at interest rates lower than those charged by other financial providers. In addition, SACCOs have the ability and opportunity to reach clients in areas that are unattractive to banks such as rural or poor areas. The core objective of SACCOs is to ensure members empowerment through mobilization of savings and disbursement of credit (Ofei, 2001). SACCOs in Kenya in their struggle to achieve this objective have been able to mobilize over Kshs.200 billion in savings (Co-operative Bank of Kenya, 2010).

There is rising number of financial institutions and other sources of finance to SMEs in Kenya. This is largely due to the fact that the government is recognizing the potentially significant contribution of SMEs to the realization of Vision 2030 development roadmap. The effect of funding source on SMEs growth in Kenya is yet to be established

## **2. METHODOLOGY**

### **2.1. Research Design:**

The research adopts descriptive research design since it is deemed to be the most appropriate in describing the situation as it is (Kothari, 2008). The choice of the descriptive research design is further informed by the nature of specific research questions which use questionnaires and direct interviews, to obtain data and answers to research questions. Descriptive research design consumes less time and is simple to carry out, Mugenda and Mugenda (1999). It also portrays accurate responses, which enable researcher to get real effects of funding source on growth of SMEs within Juja town, Kiambu County, Kenya.

### **2.2. Target Population:**

Brinker (1980) defines a target population as a large population from which sample population is selected. The target population of this study was 60 operators of SMEs within Juja town, Kiambu County, Kenya. The researcher targeted prospective respondents who constituted the target population in an attempt to determine the effects of funding source on growth of SMEs.

### **2.3. Sample Size and Sampling Technique:**

The research targeted an approximate population of 60 SMEs. To obtain the desired sample size of the SMEs to be used in the study, the researcher used a table for determining the needed size of a randomly chosen sample from a given finite proportion suggested by Kathuri and Pals (1993). For a finite population of 60 SMEs, the given sample size from the table is 52 SMEs (Appendix II).

The researcher enlisted the 60 SMEs in Juja town and assigned a number from 01 to 60 in which it forms a list of the sampling frame. The researcher also used a three-digit table of random numbers to select respondents to be included in the study by selecting the first two digits of each selected number from the table. 52 numbers were randomly selected (Appendix VI). The numbers selected will not be greater than 60. According to Kothari (2004), random table numbers are only used when lists are available and items are readily numbered.

### 3. RESULTS AND DISCUSSION

#### 3.1. Response Rate:

The researcher targeted a population of 60 SMEs operating different types of businesses within Juja town. Due to field conditions and unavailability of some owners and/ or managers of SMEs at the time of collecting filled questionnaires, 51 duly filled questionnaires were returned. This information is shown on table 3.1;

**Table 3.1 Response Rate**

Questionnaires given out	Questionnaires filled and returned	Questionnaires not filled	Response rate
60	51	9	85%

This translates to 85% response rate. According to (Mugenda & Mugenda, 2003) 50% response rate is considered adequate for data analysis to take place while 70% is considered to be a very good basis for data analysis and a reliable conclusion. This is also in line with (Babbie, 2004) who states that 70% response rate is considered adequate for data analysis. Therefore, a response rate of 85% is adequately viable for data analysis, reliable discussion and conclusion.

#### 3.2. Respondents' Rating of the Growth of SMEs:

Based on their own experiences in operating different SMEs, respondents were asked to rate their firms' growth. These findings are as shown on Table 3.2.

**Table 3.2: Growth of SMEs**

Performance Rating	Frequency	Percent	Cumulative Percent
Low	11	22	22
Average	27	53	75
High	13	25	100
<b>TOTAL</b>	<b>51</b>	<b>100</b>	

From the findings on table 4.3, it is evident that majority 53% of the respondents rated their SMEs on average performance, in terms of growth. 25% of the respondents rated their SMEs growth as high, while minority 22% rated their growth as low. Following the large number of the respondents who indicated average performance, it is evident that most of the SMEs in Juja have an average growth rate.

#### 3.3. Whether Growth is Affected by Source of Funding:

The study sought to establish respondents' opinion on whether SMEs' growth was affected by the source of funding used.

**Table 3.3: Whether Growth is Affected by Source of Funding**

	Frequency	Percent	Cumulative Percent
Yes	37	73	73
No	14	27	100
<b>TOTAL</b>	<b>51</b>	<b>100.0</b>	

Table 3.3 clearly indicates that majority (73%) believed that their SMEs growth was subject to the sources of funding used by the firm as opposed to the minority (27%) that were of the contrary opinion, stating that their organizations' growth was not subject to the sources of funding. Based on these responses, it is therefore evident that sources of funding affect growth of SMEs in Juja town.

### 3.4. Sacco Funding:

#### 3.4.1. Efficiency of Sacco Funding:

The study necessitated and investigation into the efficiency of sacco funding. The rating of efficiency was done on a scale of very efficient, moderately efficient, and not efficient. The findings are presented on table 3.4;

Table 3.4: Efficiency of Sacco Funding

	Frequency	Percent	Cumulative Percent
Very efficient	12	24	24
Moderately efficient	23	45	69
Not efficient	16	31	100
<b>TOTAL</b>	<b>51</b>	<b>100</b>	

The tables indicates that 24% of the repondents believe sacco funding is very efficient for SMEs, the majority, 45% stated that sacco fundings are moderatly efficient as 31% indicated that the fundings are not efficient. These findings indicate that sacco fundings are moderately efficient and can therefore lead to growth of SMEs to a moderate extent. Cumilatively, the responses stating that sacco fundings are very efficient and moderately efficient is more than 50% indicating that sacco fundings are efficient as opposed to not efficient.

#### 3.4.2. Interest Charged:

The study sought to find out the interest rates charged by the SACCOs on the loans given to SMEs as this would enable the researcher to know how expensive Sacco funding is. The findings are presented on table 3.5;

Table 3.5: Interest Charged by Saccos

Interest Charged (%)	Frequency	Percent	Cumulative Percent
<b>8-12</b>	40	78	78
<b>13-17</b>	6	12	90
<b>18-22</b>	5	10	100
<b>Above 23</b>	-	-	
<b>TOTAL</b>	<b>51</b>	<b>100</b>	

The findings on table indicate that a large proportion of the respondents stated that they were charged an interest rate of 8%-12% represented by 78% of the respondents. A much lower proportion of the respondents, 12% cited an interest rate of between 13% and 17%. The least proportion of 10% agreed to having been charged an interest rate of between 18% and 22%. None of the respondents indicated as having been charged an interest rate of above 23%. These findings show that compared to bank loans, Sacco funding is less costly as they mostly charge an interest rate of between 8% and 12%. A low interest rate points to higher growth rates.

#### 3.4.3. Efficiency of Sacco Funding:

Collaterals play a major role in determining the affordability of a funding source. The collateral required also shows the value that is held up by the funding source. In most cases, the higher the value of collateral, the less attractive a funding source. For SMEs, a low value collateral indicates a larger room for growth. The findings on collaterals required for Sacco funding are shown on table 3.6

Table 3.6: The Collaterals Required

Types of Collaterals	Frequency	Percent	Cumulative Percent
Pay slips	30	59	59
Title Deed	4	8	67
Logbook	1	2	69
Others	16	31	100
<b>TOTAL</b>	<b>51</b>	<b>100</b>	

The findings on table 4.12 show a large number of the respondents, 59% stating that the Sacco mainly ask for pay slips to process loans for them. The lowest proportion of 2% stated that the banks require logbooks from them, 8% stated that their title deeds were required as collaterals and 31% indicated that other forms of securities were required from them mainly their savings with the Sacco. From these findings, Sacco funding is slightly less costly considering the value of the collaterals required. A cheaper loan gives room for growth in an organization.

### 3.5. Effect of SACCO Funding on Growth of SMEs:

The study necessitated an investigation into the effects of SACCO funding on growth of SMEs in Juja. The findings on this are presented on tabel 3.7;

**Table 3.7: Effects of SACCO Funding on Growth of SMEs**

		Strongly Agree	Agree	Undecided	Disagree	Strongly Disagree
SACCO funding is more friendly in terms of interest rates and gives room for business expansion	<b>Freq</b>	19	13	7	6	6
	<b>%</b>	37	25	14	12	12
SACCOs do not require very valuable collateral as a reasonable number of SACCOs require only savings to give loans to SMEs	<b>Freq</b>	21	14	9	-	7
	<b>%</b>	41	27	18	-	14
SACCOs are not stringent on the modes of repayment of their loans and this gives room for growth	<b>Freq</b>	22	15	11	3	-
	<b>%</b>	43	29	22	6	-

Table 3.7 shows findings on the respondents' views on the effects of SACCO funding on growth of SMEs. According to the table findings, 37% of the respondents strongly agreed that SACCO funding is more friendly in terms of interest rates and gives room for business expansion as 41% strongly agreed that SACCOs do not require very valuable collateral as a reasonable number of SACCOs require only savings to give loans to SMEs and 43% of the respondents stated that SACCOs are not stringent on the modes of repayment of their loans and this gives room for growth. Following these findings, it was evident that SACCO funding gives room for growth to SMEs.

### 3.6. Correlation Between Sacco Funding and SME Growth:

To establish whether Sacco funding affects SME growth, Pearson correlation was done between Sacco funding and organizational growth. This is shown on table 3.8;

**Table 3.8: Pearson Correlation between sacco funding and SME growth**

Sacco funding	Growth of SMEs
Pearson correlation	0.006**
Sig (2-tailed)	0.002
N	51

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

There is a significant positive correlation between Sacco funding and SME growth  $r = 0.006$ ,  $p < 0.01$ . When an SME sources for funds from a Sacco, it is likely to experience improved growth. The growth of the SMEs using the Sacco loan funds is based on the features of these loans. SACCOs are able to advance loans at interest rates lower than those charged

by other financial providers. In addition, SACCOs have solid bases of small saving accounts constituting a stable and relatively low-cost source of funding and low administrative costs (Branch, 2005).

#### **4. CONCLUSION**

The study findings on the effect of the Sacco loans on SMEs suggest a significant effect on growth is realized when SMEs use this source of funding. When funds from Sacco are used, SMEs are able to realize improved growth. The study ascertained that the requirements needed from a business to be given a loan from a Sacco are not so stringent and as a result, SMEs can get efficient funding from Sacco.

It is evident that a funding source plays a crucial role in determining the growth of SME. The Sacco loan can increase the growth of the SMEs through the increase in the employee number, the number of branches, the inventory and the number of products.

#### **5. RECOMMENDATIONS**

This study recommends that more effort should be directed towards making the Bank loans and the Sacco loans available to the SMEs at various levels. To attain this, the study proposes that the barriers hindering the access of the fund by various SMEs should be minimized or if possible be removed completely. The study also proposes that saccos should embark on various reforms such as introduction of on line processing, as well as intensive advertising and marketing to keep up with today's technology and outreach to a wider market which in turn be enlightened SMEs who are not using either of the funds on the positive influence of the fund on their SMEs growth.

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