

Effect of Business Financing on the Performance of Small and Medium Enterprises in Lurambi Sub-County, Kenya

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Abstract

The purpose of this study was to examine the effect of sources of business financing on the financial performance of Small and Medium enterprises in Lurambi Sub-County. Specifically, the study sought to examine the effect of commercial loan-financing on the financial performance of Small and medium enterprises; to assess the effect of retained earnings financing on the financial performance of Small and medium enterprises and to establish the effect of trade credit financing on the financial performance of Small and medium enterprises in Lurambi Sub-County. Descriptive survey was used. The population of interest comprised of 450 small and medium enterprises in Lurambi Sub-County. Stratified random sampling was used to select 88 small and medium enterprises. The survey instrument used was questionnaires which were administered to owners and managers. Analysis of data was done using descriptive and inferential statistics. The study established that sources of business financing affected financial performance of small and medium enterprises significantly; commercial loan financing affected financial performance significantly; retained earnings financing affected financial performance significantly; trade credit financing affected financial performance of small and medium enterprises significantly. The study recommends that small and medium enterprises should make use of commercial loan financing, retained earnings financing and trade credit financing for them to realize higher levels of financial performance. The Government of Kenya should encourage lenders to share the financing risks with the government in order to reduce the cost of financing.

Keywords: Business Financing, commercial loan financing, trade credit, small and medium enterprises

1 Introduction

The small and medium-sized enterprise (SME) sector is important to national economies because it contributes significantly to employment and GDP, and because its growth is linked with the formalizing of an economy. In many countries, the majority of jobs are provided by SMEs. In the 30 high-income countries of the Organization for Economic Cooperation and Development (OECD), SMEs with fewer than 250 employees represent over two-thirds of formal employment. In high-income countries, and some middle-income countries, the sector accounts for over half of national output (OECD, 2005). In global surveys, including the World Bank's Enterprise Surveys and Investment Climate Assessments, SMEs report that the cost of finance is their greatest obstacle to growth and rank access to finance as another key obstacle (Beck, 2007). SMEs are more financially constrained than large firms and in addition, lack access to external finance which is a key obstacle to firm growth, (Schiffer, & Weder,2001).

The SME market has been perceived in the past by banks as risky, costly, and difficult to serve. However, banks are finding effective solutions to the challenges such as determining credit risk and lowering operating costs, and are profitably serving the SME sector. For these banks, unmet SME demand for financial services has become an indicator of opportunity to expand their market share and increase profit (De la Torre, 2009). Banks have begun to target SMEs as a profitable segment. For example, 91 banks in 45 developed and developing countries found that these banks overwhelmingly perceived the SME sector as a large market with good prospects (Beck, Asli Demirgüç-Kunt, & Maria, 2008). The significant expansion in lending to small and medium enterprises in the developed world over the last couple of decades may be one reason why only 30 percent of OECD (developed) countries report a gap in bank financing of SMEs. This is compared with 70 percent of non-OECD (developing) countries responding to an OECD survey of government policy experts (OECD, 2006).

In the U.S.A, SMEs with fewer than 500 employees are the backbone of U.S. economy. They make up 99 percent of all firms, employ over 50 percent of private sector employees, and generate 65 percent of net new private sector jobs. SMEs account for over half of U.S. non-farm GDP, and represent 98 percent of all U.S. exporters and 34 percent of U.S. export revenue (Aseem, 2014). Indeed, financing is widely found to be the single most robust determinant of firm growth in the U.S. The financing challenges faced by SMEs were compounded by the 2008-09 financial crises, which severely undermined SMEs' credit conditions. Bank lending to SMEs has improved, but has yet to return to pre-crisis levels (Ayyagari et al., 2006). In June 2013, the loan balances for commercial and industrial (C&I) loans of \$1 million or less stood at \$288.7 billion, \$47 billion below June 2008 preceding the Great Recession. The annual decline in small-business lending in 2008-2012 has reversed, yet particularly the smallest of SMEs have trouble securing a loan, and loans are not as substantive as

they used to be. The total number of small business loans has been increasing from 2009-2011, however the average loan size is still below 2010 levels (Aseem, 2014).

In the UK access to finance for small and medium enterprises (SMEs) is key to the recovery and long term growth of the UK economy. The principal providers of external finance are the major UK banks. Accordingly, the financial crisis was bound to have an impact on SME finance through the failure and partial nationalization of banks, higher bank funding costs and the subsequent recession (Armstrong, 2013). At the start of 2011 there were around 4.5 million SMEs forming 99.9 per cent of all businesses by number, accounting for over half of private sector employment and nearly half of all private sector turnover in the UK (BIS, 2010).

In Japan SMEs account for 99.7% of all companies, 70% of all employees, and more than 50% of all added value (manufacturing industry), SMEs form the very basis of the Japanese economy (Ministry of Economy, Trade and Industry, 2013). The economies of Japan's provincial areas are supported by the activities of SMEs – mainly in the service industry, retail trade, and the construction industry – and SMEs play a part in revitalizing local economies and boosting employment opportunities. As SMEs have few assets and weak financial foundations, it is difficult for them to procure capital from the stock market, so securing a smooth supply of funds is one of their key challenges. Accordingly, government-affiliated financial institutions have been established to create a system to provide SMEs with long-term funds at low rates of interest (Ministry of Economy, Trade and Industry, 2013). The average SME gets over 50% of their capital in the form of loans from financial institution (Hakusho, 2001). In general, the smaller the firm, the more it depends on borrowing for funds. In 2001, firms with less than 20 employees received 66.9% of their capital from loans by financial institutions whereas firms with more than 300 employees received just 24.2% of their capital from such loans. Therefore SMEs' heavily rely on bank lending (The Small and Medium Enterprise Agency, 2012).

In China, Small and medium-sized enterprises have played an active role in economic growth. 99.6% of enterprises in China are SMEs. These enterprises account for 59% of GDP, 60% of total sales, 48.2% of taxes, and about 75% of employment in urban areas (National Bureau of Statistics, 2005). SMEs' participation in international trade and outward investment is also very significant, representing 68.85% of the total import and export values and about 80% of outward investment (Yan et al., 2008). In contrast to its contribution to the economy, the difficulty of SMEs to obtain external financing from formal financial institutions is widely recognized. Lin (2007) documented that no more than 0.5 million of over 40 million SMEs could obtain bank loans in 2006. In other words, over 98% of SMEs have no access to bank lending. The World Bank Investment Climate Survey for China also indicates that SMEs in China are facing greater credit constraints and have more limited access to bank loans than in other Asian countries.

Approximately 300,000 Small and Medium Enterprises (SMEs) are active in Ireland and Northern Ireland employing 1.4 million people. This represents almost 70% of the total work force on the island of Ireland. SMEs represent 99.8% of all enterprises in Ireland and 99.9% in Northern Ireland (Inter Trade Ireland, 2013). 94% of total SME finance for both Irish and Northern Irish SMEs came from bank lending. In comparison to European SMEs, Irish and Northern Irish SMEs demonstrate an overreliance on short term bank finance with a disproportionately high use of overdrafts (Inter Trade Ireland, 2013).

In low-income countries too, SMEs play a sizable role, though the informal economy is more dominant (Maina, 2006). According to Sacerdoti (2005), among the reasons for lack of access to credit from banks in Sub-Saharan Africa is inability of borrowers to provide accurate information on their financial status, absence of reliable and updated company and land registries, weak claim recovery and collateral realization process (Frempong, 2007). According to Kapila et al., (2002) in order to strengthen this position of SMEs, access to financial and non-financial services should be made available to them because it contributes to the performance and expansion of these enterprises. SME contributes to about 90% of the total job creation (Kofi et al., 2013) therefore access to credit is important for the growth and development of Small and Medium-sized Enterprises (SMEs) in Ghana. Bank lending is the leading factor stifling the growth of small businesses in Ghana. Very demanding requirements, in addition to the bureaucratic lending procedures by the formal financial institutions is the biggest challenge to credit access by SMEs. This is also what leads most SMEs to resort to informal financial institutions such as savings and loans companies, traditional money lenders, friends and relatives (Association of Ghana Industries, 2013).

In Tanzania, SMEs play a significant role in job creation, poverty reduction and reducing inequality in the economy. The sector employs over 33% of the labor force (Kira, 2013). When taking the informal sector together with the formal sector, the total contribution of the sector to GDP is about 63%. Moreover, about 700,000 job seekers enter the labor market each year. The formal sector absorbs only 40,000 annually. The implication is that the remaining excess annual labor supply of about 660,000 are absorbed by SMEs or left unemployed (Kira, 2013). Bank lending has been mentioned to be top most challenge to many SMEs. Given the commercial orientation of the conventional financial system, it may not be surprising to see that banks are not lending to SMEs. This is because SMEs are risky in nature (either perceived or real or both), small in size, have high transaction costs per service and may lack transparency in their operations. Therefore, reckless lending to

this market segment may jeopardize the core business of the formal banking system (Nyankomo, 2014). As part of the solution, the recent resurgence of development finance institutions including microfinance has played a key role as an alternative financing mechanism in this market segment (Nyankomo, 2014).

The Kenya government in the Vision 2030 plan has identified the SMEs as an important priority. In order to achieve performance, adequate sources of finance are needed for SMEs (Kuria, 2014). Bank lending to small and medium sized enterprises (SMEs) is important to allow SMEs to start up and finance investment for growth. There has been widespread comment regarding the continued difficulty SMEs perceive in obtaining bank financing since the financial crisis of 2008 (Armstrong, 2013). In Kenya, the SMEs employs about 5.1 million people representing 74% of the total national employment and also contribute about 88% of the total job creation at any one time; they also contribute in the Gross Domestic Product of the country, whereby they contribute about 24.5% to the GDP (Maina, 2006). There is a concern that banking systems are not providing enough support to new economic initiatives and in particular to the expansion of SMEs and agriculture sector. Faster economic growth will not be possible without deepening of the financial system and in particular, more financial support from the banking sector to the SMEs.

Banks remain highly liquid and reluctant to expand credit other than to most credit worthy borrowers which in most cases excludes the SMEs (Sacerdoti, 2005). Empirical studies in Kenya (Njoki et al., 2014) assessed the impact of micro financial institution funding on performance of SMEs found that there was a significant positive relationship between FI funding and performance on SMEs namely Credit with performance of SMEs. Ayuma et al., (2014) also found out that SMEs still seek for alternative bank financing. This therefore, demonstrates that bank lending influences performance of SMEs.

Recognizing the importance of the SME sector; governments have undertaken a variety of measures to support SME access to finance. These measures range from reforming existing legal barriers, taking actions to develop the SME finance market broadly, and intervening in the market directly to jumpstart or incentivize lending to SMEs (Beck, 2009). In Kenya for instance, the Government enacted the Micro and Small Enterprise (MSE) ACT aimed at providing an enabling policy and legal environment for MSEs. The Government has also tried to ease the financing constraints of the sector through the establishment of the Women enterprise fund, the Youth Enterprise Fund and the Uwezo Fund (GoK, 2012).

The meaning of the term SME varies from country to country; however, most definitions are composed by either the number of employees and/or capital requirement as a classification factor (Van der Vaart, 2008). A common definition of SMEs includes registered businesses with less than 250 employees (Kozak, 2007). Currently the SME Department of the World Bank has the following definitions: Small Enterprises are defined to have up to 50 employees, with total assets and total sales of up to \$3 million while Medium Enterprise is one that has up to 300 employees, having total assets and total sales of up to \$ 15 million per annum (Ayyagari et al., 2007). The definition used to describe the SME sector in Kenya are based on employment size and include both paid and unpaid workers (Gok 2006; ILO 2008). A micro-enterprise is defined as having no more than 10 employees; a small enterprise with 11-50 employees and a medium/large enterprise with more than 50 employees. The findings of the 1999 National Micro and small Enterprises Baseline Survey estimated that there about 1.3 million SMEs in Kenya, employing an estimated 2.4 million people. The average income of the enterprises surveyed was about Kenya shillings 6,000 per month, which was more than two times higher than the minimum legal monthly wage for skilled employees. The SMEs sector experienced substantive growth from 2000-2002 increasing to 2.8 million enterprises and SMEs employment of 5.1 million persons, accounting for 74.2 percent of the total employment in 2002. SMEs are spread widely across the country, with two thirds of them located in rural areas (Gok 2006; ILO 2008). In Kenya significant numbers of SMEs engage in commerce with 74 percent and 66 percent in urban and rural areas respectively (Liedholm, 2002). The financing of small and medium sized enterprise has been of great interest both to policy makers, private sectors and researchers. This study on effect of business financing and performance of SME will assist in promoting growth and competitiveness of the sector.

1.1 Statement of the Problem

Kenya's transition to market economy and the accompanying reforms measures in the financial sector during the past decades has brought about a general policy environment and an overall regulatory framework (GoK, 2005). This encourages formal institution to provide financial services to different groups of businesses, including low income segments of the population and small and SMEs in both urban and rural areas. In spite of the generally fast pace by which access to financial services for SME is being developed, significant segments of the SME sector do not yet benefit from the expansion and deepening of outreach (Thaimuta, 2014). SMEs play an important role in the development process and continue to be the forefront of policy debates not only in developing countries but also in developed countries. The advantages claimed for SME are various, including the encouragement of entrepreneurship, and wealth creation (Sacerdoti, 2005).

In developed and developing economies SMEs contribute on average 60% of formal employment

(Oguta et al., (2014). However, the ability of SME to grow depends highly on their potential to invest in restructuring and innovation (Ayyagari et al., 2007). The rate of SMEs failure in developing countries as well as developed countries is alarming. 33% to 41% of new SMEs fail within the first five years of their business operation due to lack of finances (Thaimuta, 2014). Three out of five SMEs fail within their first three years of operation in Kenya (RoK, 2007). It is therefore widely recognized that ‘business financing and lending gap’ exists in the provision of modest amounts of finance to SMEs since all investments need capital. SMEs continue to face constraints caused by many common factors including commercial bank’s lending policies. In line with this argument, business financing has influence on performance of SMEs (Sabana, 2014). In contrary, (Ifeakachukwu et al., 2013) found out that commercial loan financing to the SME sector had insignificant impact on their performance. Such contradictory and inconclusive evidence by different scholars have conflicting implications for practice and theory development, hence the need for further research. Small and medium enterprises (SMEs) in many countries have received a lot of attention and support from governments and other stakeholders (Timoshenko, 2012; Wang, 2013; Joeveer et al., 2006; Klapper, 2006; Husnah et al., 2013; IFC, 2013; Agbozo & Yeboah, 2012; Wangu, 2011; Memba et al., 2012; Onakoya et al., 2013), however their financial performance is still wanting: (Xiao, 2014) many have stagnated at the same level, they have remained small and others are on the verge of collapsing. They have shown a lot of volatility in returns, growth and have failed to break even in their trading activities. They still experience a large financing gap and they have problems in financing and refinancing their business operations. In Kenya, there is still a large financing gap among the SMEs. Their financial performance can be described as stagnant, failing and three out of five SMEs hardly make it past a few months after their creation (Osoro & Muturi, 2013; Siekei, Wagoki & Kalio, 2013; Njeru et al., 2012; Hassan & Mugambi, 2013; Wawire & Nafukho, 2010; Muteru, 2013; Chipkemoi, 2013).

Kihimbo et al., (2012) identifies financing as among the major problems facing SMEs in Kakamega Municipality. They hampered the ability of SMEs to grow and survive, threatened their financial performance, hence they would hardly make it into the league of successful enterprises to reckon. Many SMEs have (Njeru et al., 2012) performed poorly in their starter up period and have difficulties in funding their operations. Berger and Udell (2004) and Abouzeedan (2003) still claims that more research needed to be undertaken in the area of SMEs financing to unearth what ails them as the firms have shown a comparatively poor financial performance. Hence this study sought to test the effect of sources of business financing on financial performance of SMEs in Lurambi Sub-County.

1.2 Objectives of the study

The main objective of the study was to examine the effect of business financing on financial performance of Small and Medium Enterprises (SMEs) in Lurambi Sub-County.

1.2.1 Specific Objectives

- i). To examine the effect of commercial loan financing on the financial performance of small and medium enterprises in Lurambi Sub-County
- ii). To determine the effect of retained earnings financing on the financial performance of small and medium enterprises in Lurambi Sub-County
- iii). To establish the effect of Trade Credit financing on the financial performance of small and medium enterprises in Lurambi Sub-County

2.0 Literature Review and Hypothesis Development

2.1.1 Commercial Loan Financing and Firm Performance

Commercial loan financing describes the funds borrowed from private individuals, banks, co-operatives, micro-finance institutions and other lenders to support SMEs business operations (Munyuny, 2013). The funds are borrowed under the terms and conditions of the lending party and the borrowing SME is normally required to pay back the principal amount plus interest. Commercial loan financing is measured by funds usage, sustainability of funds and repayment period.

Timoshenko (2012) argues that commercial loans constitute a major source of external funding for the Latvian SMEs. In 2009, it rose from 33% to 35% in 2012, signifying its importance as a financing option favoured by entrepreneurs in the SMEs business. This prompted the Latvian Government to come up with programmes that would see the operators in the sector access more funding from commercial banks. In such cases the Government takes the position of a guarantor to institutions advancing loans to SMEs by covering all costs in cases where the SMEs become bankrupt. The Parliamentary Act has seen many firms access more funds to start and operate their business. Vo et al., (2011) observes that firms at start-up stage had reservations in sending loan requests to banks in Vietnam. They either assumed that they did not urgently require commercial loans or it was hard to attain approval for formal loans due their stage in business cycle. However, their counterparts; those that were in operation for some times (about 86%) found it very appealing to use commercial loans to launch expansion programmes and keep their business activities in operation than other forms of

financing. Mishra and Soota (2014) recognized commercial loans as a vital source of financing that can be utilized by firms to expand their projects, modernize and renovate their existing equipment and carrying out technological updates.

Abouzeedan (2003) states that the Small Business Administration (SBA) an American Government agency participates in SMEs funding by encouraging and motivating banks and other financial institutions to lend to SMEs and start-up ventures by guaranteeing up to 90% of the loan amount to qualified borrowers. The study believes that commercial loans remains a principal source of financing for SMEs in Sweden into the unforeseeable future even though SMEs continue facing competition from large businesses for the same funds. Agbozo and Yeboah (2012) observes that 53% of respondents intimate to be using commercial loans as a key source of financing with 35% indicating that access to loan had risen over the period and loans were mostly preferred as they basically depended on the good relationship between the borrowers and the lenders. Xiao (2014) claims that SMEs that utilized commercial loans reduced financial distress allowing them to finance more projects hence, generating more cash flows. Quianoo (2011) outlines reasons that may push SMEs to seek commercial loan funding as to finance activities such as opening new branches, commencing new investment projects among other factors. Commercial loans were mostly suited for SMEs financial needs as they were more realistic and reliable in European countries as they lacked options such as those available to large enterprises such as issuing shares and debentures in the capital markets.

Egbuna and Agali (2013) observe that 20% of respondents in the study indicated that they obtained their commercial loans from banks and 22.9% sourced from friends and relatives at a fair interest in Nigeria. Osoro and Muturi (2013) still observes that 50% of respondents in the SMEs obtained their initial capital as commercial loans from Micro-Finance Institutions (MFIs) and 20% acquired their loans from friends in Kisii-Kenya. Kihimbo et al., (2012) claim that among the SMES in Kakamega Municipality in Kenya, commercial loans were some of the sources of beginning capital. These loans were acquired from friends, Commercial banks and MFIs. All these prior studies alludes to the fact that commercial loans have been utilized by SMEs to finance business operations ranging from start-up capital and capital to finance continuing activities at various levels of business cycles.

Commercial bank lending sets the objectives, standards, and parameters that guide loan officers in granting loans and management of the loan portfolio. The lending policy provides a framework within which the credit risk arising from lending will be originated and managed in order to minimize the risk of financial loss (Othieno, 2010). Carpenter et al., (2002) argue that firms whose financial needs exceed their internal resources may be constrained to pursue potential opportunities for growth. The insufficient internally generated liquidity is therefore one of the factors which are frequently cited as the causes of small and medium business failure in developing economies. Makokha (2006) revealed that inadequacy of capital hinder the expansion of businesses. His study further found that larger loans enabled MSEs to graduate to medium enterprises. Appropriate loan sizes for clients matching their needs, realistic interest rates, savings as a prerequisite, regular, short and immediate repayment periods and achieving scale can contribute to the sustainability of small and medium enterprises.

Providers of credit attribute to the high interest rate to high cost of administration of overdue loans and defaulters which eventually push up lending cost without corresponding increase in loans turnover. Defaulters of loan reduce financial institutions resource base for further lending, thus, weaken staff morale and affecting the borrower's confidence. The consequence is that financial institutions must set the risk premium sufficiently high to compensate for the risk leading to differentials in the required return and the expected return on a loan. Saunders et al., (2007) added that the promised return on the credit may well differ from the expected return on a credit due to the presence of default risk. However, the lender has to recognize that by setting high risk may have actually reduced the probability of repayment. In Africa, loan repayment performance has been very poor and this has affected the small business financing. For instance, about 45% small agriculture loans granted in Ghana are not repaid as bemoaned (Aryeetey et al., 2000).

Rosenberg et al., (2009) supported that financial institutions prefer large loans because the administrative costs decrease proportionately to the size of the loan. SMEs consider small loans amount to meet immediate needs because SMEs don't have capacity or experience to handle large sums of money in their businesses and even can lead to business failure. Short-term debt is the best financing tool because it is perceived to be cheaper (Jun et al., 2003). Short term debt adapts more easily and facilitates bank relations between the firm and the lender due to frequent renewals and hence firms might obtain credit condition benefits. Short term debt loans solve the problem of underinvestment because management is more frequently monitored due to periodic credit renewal. Ozkan (2000) argues short term debt can mitigate agency conflicts between shareholders and debt holders. SMEs in their limited asset base have no potential of securing long term loans as a major instrument of debt financing hence giving it a major constraint in borrowing funds to finance their operations. This in turn limits sources of financing are available to SMEs. Pelham (2000) argued that long term debts provide small firms with more competitive advantages when compared with large firms. According to his

study there was is a direct positive and significant relationship between long term loans and financial performance of the small businesses.

Loans are given depending on savings with financial institution and the SMEs previous loan repayment. Most of these loans are lent out depending on the collection convenience, payment and flexibility with experienced clients. Financial institutions tend to meet their clients working capital by giving short term loans and limit long term loans. Financial institutions cite weak SME management and governance, unreliable financial information on SME operations, lack of medium- and long-term resources for typical SME lending, and complicated procedures to register and seize collateral as the main constraints to funding SMEs with large loans amount (Odongo, 2014).

SMEs tend to lose commitment of repaying the loan because of the small loan amount borrowed and there is high possibility of not performing to the expectations of the FIs since they also don't meet SMEs needs as they expect to bigger amount of loans. While the loan size can have some impact on the SMEs performance but it is minimal compared with those of big loan size in the same sector and its relationship to create good performance is insignificant to this kind of businesses (Odongo, 2014). Thus it is vital that the current establishes the relationship between this variable (commercial loan financing) and financial performance of the firms in question (SMEs).

Therefore, the following hypothesis is formulated based on the above discussions:

H4: There is a significant relationship between commercial loan financing and firm performance.

2.1.2 Retained Earnings Financing and Firm Performance

The relationship between retained earnings and firm performance has been established by many researchers (Frank and Goyal., 2005; Njeru et al., 2012; Wang., 2013). Frank and Goyal (2005) while discussing financial theories underscored the fact that financial managers have a tendency to utilize retained earnings compared to external funding. Retained earnings (Njeru et al., 2012) constitute to be an important source of financing for established SMEs in developing economies. Wang (2013) argues that Chinese SMEs in Taizhou depended on retained earnings as a source of financing to a level that Micro-financing which was formerly a popular source of funding lost prominence among its customers. The net effect was a sustained decrease in micro financing; on average doubling the application of retained earnings led to a decline in the usage of micro financing by a staggering figure of 22.8%. The consumption of retained earnings by SMEs as a form of funding meant a decline in the utility of some alternative funding. Abouzeedan (2003) clarifies this trend by asserting that retained earnings are one of the cheapest financing sources that SMEs can access and utilize. Retained earnings are becoming handy among Swedish SMEs during times of resource scarcity; especially as their number continue to balloon overstretching the available financing options. Xiao (2014) claims that use of ploughed funds prevented firms from being undervalued hence, motivating finance managers to opt for this form of funding.

Timoshenko (2012) argues that once firms survived the first phase of the growth cycle, they had a tendency of delinking funding efforts from personal savings and instead depended on retained earnings to finance business expansion programmes. Retained earnings are a vital funding option during periods of external funding distress along the SMEs growth and economic cycles (business life).Agbozo and Yeboah (2012) underscore the importance of retained earnings financing when the study claims that 25% of respondents in Ghana agreed that they considered it as a vital source and used it to finance their business operations.

Kyokutamba (2012),Egbuna and Agali (2013) highlight the significance of retained earnings in financing SMEs' start-up and operational activities. In Nigeria 21.4% of respondents agreed that they sourced their finances from retained earnings; this is in line with prior studies which highlighted this fact. Chepkemoi (2013) asserts that SMEs in Kenya heavily depended on retained earnings to finance their investments in their early stages of inception. This was due to the fact that they were still young and had not established sufficient network to qualify for external financing. The popularity of retained earnings as a form of financing among SMEs, calls for a critical examination of their effect on the financial performance of these enterprises in Lurambi Sub-County.

Therefore, the following hypothesis is formulated based on the above discussions:

H4: There is a significant relationship between retained earnings financing and firm performance.

2.1.3 Trade Credit financing and Firm Performance

According to Munyony, 2013, trade credit refers to the credit extended to SMEs by their suppliers whom they have purchased goods or services from on a credit basis for a given period of time after which they pay later when the credit period expires. Taketa and Udell (2007); Klapper (2006); Berger and Udell (2004) asserts that trade credit in Japan accounted for 22.67% of debt financing sourced by non-farm, non-financial and non-real estate for profit SMEs and in the United States of America in the same segment, it was about one-third. This is almost equal to commercial bank financing to the same segment in the States. In economies with less well established financial systems and with weak legal systems that make financial contracts difficult to enforce, SMES and other firms might find trade credit a very useful tool and an alternative form of financing that can fill the prevailing financing gap. The size of trade credit extended to SMEs is determined by the type and nature of

the product in question. Trade credit will be high if the product is less divestible hence non-standardized. The study contents that during the Japanese financial crisis, trade credit was more extensively used compared to all other financing options combined. Trade credit is of great importance in developing countries especially for firms that are less credit-worthy in the eyes of other forms of lending and lenders in the financial markets. Munyuny (2013) claims that trade credit was an important source of funding as it enabled firms to cut down on the transaction costs, led to reduction on risk, allowed enterprises to benefit on discounts and was an important tool in correcting market imperfection in emerging economies and in times of financial crisis in developed economies.

Timoshenko (2012) claim that trade credit application was on the upsurge among Latvian SMEs. Its usage increased by 13% from 2009 to 2012. A view that is shared by Abouzeedan (2003) when commenting that short term credit is heavily depended on by SMEs especially trade credit as it is highly flexible and less volatile. This is because renewal can be done as many times and it can be easily converted into long-term finance. Xiao (2014) observed that SMEs that utilized trade credit expanded their operations faster in emerging economies where financial institutions were underdeveloped. Firms can also utilize it whenever they are facing emergencies that they were unprepared to handle during liquidity crisis in the short-run both in the first and third world economies (Munyuny, 2013). Agbozo and Yeboah (2012) found that in Ghana 83% of respondents agreed that they used trade credit as a form of financing and 67% agreed that accessibility to trade credit had improved over the years. It was mostly utilized by SMEs as traders preferred to use it as a refinancing tool with a view to patronizing their product chain of distribution. Kihimbo et al., (2012) observes that 6.7% of SMEs in Kakamega Municipality used trade credit as their initial capital to finance up to 10% of their new business ventures. There is all indication that trade credit has been widely used as a source of financing in both developing and developed world; as a main source, as an alternative and complementary source of capital; hence the need for this study to explore its effect on financial performance of SMEs.

Therefore, the following hypothesis is formulated based on the above discussions:

H4: There is a significant relationship between trade credit financing and firm performance.

3.0 Methodology

3.1 Research Design

The study was based on descriptive survey research design. Descriptive survey tries to collect information from a representative group upon which inferences are drawn about the behaviours of the entire target population. Its main aim is to find reasons why a particular activity is happening (Zikmund, Babin, Carr & Griffin, 2010). The merits of descriptive surveys are that they enhance rapid collection of data, are economical, efficient, accurate means of assessing information about a population and are less rigid in their application (Zikmund et al., 2010; Hart, 2005). This design was employed because the study was a fact finding enquiry hence required a description of the state of affairs of the current situation after which the results would be generalizable to whole target population (Kihimbo et al., 2012; Siekei et al., 2013). Thus descriptive survey was the most suitable design for this study.

3.2 Target Population

The target population comprised of 450 active SMEs that were registered and had been in operation for at least one year during the study period of August 2014 and April 2015, have employment level of up to 100 workers and are located in Lurambi Sub-County as provided by Kakamega County Revenue Department. This area was chosen as it has one of the most promising entrepreneurs in Kakamega County. The target population is a composition of units from which a sample is to be selected (Khaemba, Manase, Musiega & Kimani, 2013). Some SMEs were excluded from the study. Those excluded were enterprises directly supported by the Government, organizations that supply credit to SMEs and enterprises which are subsidiaries of big companies outside the area.

3.3 Sampling Frame

This was made up of a list of 450 small and medium enterprises (SMEs) in Lurambi Sub-County that were currently active. The list was obtained from Kakamega County offices (Town management and Kakamega County Revenue Departments). The SMEs were classified as under three main sectors comprising of trade, service and industrial and related services. The distribution of the 450 SMEs was trade (169), services (189) and industrial and related services (92). Samples were picked from each of the above mentioned sectors.

Sample and Sampling Techniques

Table 1: Sample Size

Criteria/sector	Population	Sample size	%age
Trade	169	33	37.5%
Service	189	37	42.0%
Industrial and related services	92	18	20.5%
Total	450	88	100%

After stratifying the target population using stratified sampling, simple random sampling was used to pick the SMEs for the study from the three sectors: trade, service and industrial and related services. Random sampling was used to ensure that all members of the target population have equal chances of participating in the study. Random numbers were assigned to SMEs in the list in each stratum. Numbers were then read from the random table and elements in the frame with those numbers were included in the sample. Nassiuma cited in Osoro and Muturi (2013);Munyuny (2013);Khaembaet al., (2013) asserts that the most common method of deriving a sample size in most surveys is the use of a coefficient of variation. In this method, a coefficient of variation ranging between 21% to 30% and a standard error of between 2% to 5% are normally acceptable. Hence the study used a coefficient of variation of 21% and a standard error of 2% to minimize variability in the sample and error. Therefore, using the coefficient of variation a sample size was arrived at as follows:

$$n = \frac{N(C^2)}{C^2 + (N-1)e^2}$$

Where n = the sample size
 N = the population size
 C = the Coefficient of Variation
 e = standard error

$$\text{Hence: } = \frac{450(0.21^2)}{0.21^2 + (450-1)0.02^2} = 88 \text{ respondents}$$

Having calculated the sample size, stratified proportionate sampling method was used to arrive at the population sizes for every strata of each of the three sectors: trade, service and industrial and related services using the proportionate method from Chepkemioi (2013) which grouped the target population as follows:

$$nh = \frac{(Nh)n}{N}$$

Where n = the total sample size
 N = the total population
 Nh = the population size for stratum h
 nh = the sample size for stratum h

3.4 Research Instruments

Primary data was collected from the field. Questionnaires were used to collect primary/quantitative data from the field. Quantitative data is in numeric and results are more readily analyzed and interpreted. Questionnaires enhance rapid collection of data and are very economical (Siekei et al., 2013). Structured questionnaires had closed ended questions. The questionnaire had a declaration, instructions to respondent and the actual questionnaire items. The actual questionnaire items section was sub-divided into organizational characteristics section, the respondent characteristics, commercial loan financing, Retained earnings financing, trade credit financing and financial performance section.

3.5 Validity of the instruments

To establish content validity of the questionnaires content validity index (CVI) was (Kyokutamba, 2011) used;

$$CVI = \frac{n}{N}$$

Where n = number of items rated as relevant
 N = total number of items in the questionnaire

CVI = content validity index

With a computed content validity index of 0.8, the research instrument was valid. An instrument (Kyokutamba, 2011) with a content validity index of at least 0.5 is considered sufficient. Content validity was also achieved by discussing the construct items with the supervisors and lecturers in the HRD department. Construct validity scored fairly well as the measurement scales reflected the key components of commercial loan financing, retained earnings financing, trade credit financing and financial performance as described in the reviewed literature. It therefore follows that they are validated measures previously employed by other studies and as such they are deemed to be valid in this study.

3.6 Reliability of the instruments

Table 2: Summary of Cronbach's Alpha test results

Variable	Measure	Cronbach's Alpha	No. of items
Commercial loan financing		0.808	10
Retained earnings financing		0.750	10
Trade credit financing		0.779	10
Financial performance		0.785	8

Cronbach's coefficient, Alpha (α) method of internal consistency/homogeneity was used; which measures the consistency within the questions/instruments showing how well they measured characteristics and behaviour within the test (Kyokutamba, 2011; Sabana, 2014):

$$\alpha = \frac{K}{K-1} \left[\frac{1 - \sum \delta^2 k}{\delta^2} \right]$$

Where $\delta^2 k$ = Sum of variances of the k questions in the instrument

K = Number of questions in the research instrument

α = Alpha Coefficient

δ^2 = Variance of the total test

The measurement scales' computed Cronbach's Alpha (α) results in table 3.2 indicate that for commercial loan financing had an (α) of 0.808, 0.750 for retained earnings financing, 0.779 for trade credit financing and 0.785 for financial performance. The measurement scales were reliable as this is well above 0.6 threshold which (Kyokutamba 2011; Sabana, 2014) is the recommended coefficient for a given research instrument. Hence the internal consistency reliability of the measures used was considered sufficiently high enough to have adequately measured the study variables. This allowed for more testing and further analysis of the linear regression model.

3.7 Data Collection Procedure

Methods of administration of the instruments were self-administration and drop and collect method technique where the researcher and the research assistant left the questionnaire with an informant and went back to pick it. This method was preferred because data was collected from a large representative sample of SMEs' respondents and there was reduced bias. The owners of SMES or their personnel (managers) filled the questionnaires under proper guidance and in most instances (face to face); the filled questionnaires were picked by the team. It took approximately one week to collect data from the field

3.8 Data Processing and Analysis

Quantitative analysis was done to present the outcome of the research. Statistical packages for social sciences (SPSS) were used to carry out the analysis. Data was analyzed using descriptive statistic such as frequencies, percentages, means and standard deviations. Inferential statistics (multiple regression and correlation) analysis was carried out to test and establish relationships between sources of business financing and financial performance of SMEs

The regression model used for the estimation of a dependent variable for many independent variables is estimated as follows:

$$\text{FinP} = \beta_0 + \beta_1(\text{CLF}) + \beta_2(\text{REF}) + \beta_3(\text{TCF}) + \epsilon_i$$

Where FinP = financial performance

CLF = commercial loan financing

TCF = trade credit financing

REF = retained earnings financing

β_0 is the intercept, β_1 is the coefficient associated with CLF , β_2 is associated with REF , β_3 is associated with TCF and ϵ_i is the error term.

4.0 Data Analysis and Findings Of The Study

This section presents the descriptive statistics and the inferential analysis (correlation analysis and multiple linear regression analysis) of the study variables.

4.1 Descriptive Statistics

Descriptive analysis was basically anchored on commercial loan financing and financial performance of SMEs. Descriptive measures used were the mean, standard error, standard deviation, Skewness and kurtosis

Table 3: Commercial Loan Financing of SMEs

Commercial Loan	mean	Std. Error	Std. Dev.	Skeweness	Kurtosis
i. Easy access to funds depending on SME's ability	3.43	.082	.770	-.462	.332
ii. Flexible repayment period allowing SME enough time to repay	3.57	.064	.657	-.257	-.062
iii. The funds are less risky to use	3.61	.083	.780	-.240	-.245
iv. The funds have less restrictions in their usage and application	3.42	.085	.798	-.358	.152
v. Acquired assets pays off funding cost leaving the SME with the asset value	3.50	.079	.742	-.206	-.216
vi. The funds are self-sustaining in the long-run	3.56	.081	.757	-.118	-.271
vii. The SME retains its decision making powers after using fund	3.59	.072	.672	.009	-.177
viii. The SME is able to engage in risky ventures with high returns	3.53	.076	.660	-.128	-.143
ix. usage of the funds increases investment prospects of SME	3.58	.070	.656	-.051	-.150
x. The funds adapts more easily to SME's financial needs	3.60	.078	.736	-.097	-.210
Average score	3.54	0.077	0.723	-0.191	-0.099

Descriptive statistics in table 3 reveals the outcomes of responses toten statements formulated in line with commercial loan financing using a Likert scale of values ranging from 1 to 5. The value 1=strongly disagreed, 2=disagreed, 3=neither agreed nor disagreed, 4=agreed and 5=strongly agreed. For commercial loan financing, the average mean value was 3.54 with a standard error of 0.077, which implies that most respondentsagreed with the fact that the application of commercial loan financing had benefits highlighted by the ten statements to SMEs. With a standard deviation of 0.723; discrepancies from the mean were fairly small. The data set was normally distributed as it had a Skeweness of -0.191 (Asymmetrical) and a Kurtosis of -0.099. These results are consistent with the static tradeoff theory (Munyuny, 013) which asserts that capital structure is based on the tradeoff between the benefits and costs of commercial loan financing.

Table 4: Retained earnings financing of SMEs

Retained earnings	Mean	Std. Error	Std. Dev.	Skeweness	Kurtosis
i. The funds are attractive as project launch does not need approval of outsiders	3.83	.065	.665	-1.238	3.778
ii. The usage of funds avoids possibility of a change in control	3.84	.072	.676	-1.167	3.516
iii. Flexible they can be committed to diverse functions	3.83	.071	.665	-1.238	3.778
iv. Use of these funds increases chances of SME success	3.83	.083	.682	-1.109	3.248
v. Use of these funds avoids undervaluation of SMEs	3.87	.074	.692	-1.110	3.321
vi. Application of this funding reduces agency costs	3.95	.070	.659	-1.183	4.473
vii. Chances of receivership, liquidation and bankruptcy reduces	3.92	.075	.665	-1.353	4.638
viii. Application of these funds reduces tax burden to an SMEs	3.95	.068	.642	-1.296	5.196
ix. The usage of funds does not involve payment of cash	4.03	.063	.686	-1.138	4.081
x. The funds boost SME's credit rating: attracting more funding	4.09	.075	.689	-.552	.698
Average score	3.91	0.072	0.672	-1.138	3.673

From table 4, the average mean value for retained earnings financing was 3.91 with standard error of 0.072, which indicates that most respondents agreed with the ten formulated statements showing that retained earnings financing was important as it enabled SMEs to grow and expand their operations. With an average standard deviation of 0.672 imply that the variations of individual responses from the mean were equally small hence a good estimator of the population (Sabana 2014). The distribution had a Skeweness of -1.138 (asymmetrical) and a Kurtosis of 3.673 depicting a peaked distribution. Frank and Goyal (2005) agrees with these findings when they claim that SMEs' owners have a habit of applying retained earnings financing to expand their business operations just before seeking funding elsewhere. This is still in line (Miglo, 2013) the pecking order theory of financing which predicts that finance managers will have a tendency of using retained earnings financing over debt and equity funding.

Table 5: Trade Credit financing of SMEs

Trade Credit	mean	Std. Error	Std. Dev.	Skeweness	Kurtosis
i. Usage of this funding line reduces transaction costs for SMEs	3.93	.084	.770	-.964	2.089
ii. The funding increases the SME's credit score	4.07	.090	.841	-.960	1.355
iii. The funding are interest free hence cheap to SMEs	3.95	.080	.772	-.996	2.180
iv. Discounts are offered reducing the cost of borrowing	3.99	.076	.809	-.911	1.575
v. The funding is flexible the credit terms can be renewed	4.01	.096	.809	-.953	1.684
vi. The SME is able to finance more projects increasing returns	3.95	.088	.829	-.781	1.072
vii. Use of these funding result in high quality products	3.92	.093	.776	-.916	1.890
viii. The SME has time to plan for repayment/expenditure hence maintaining continuous production schedule	4.00	.076	.802	-.957	1.768
ix. Available funds can be committed to the most urgent needs	4.01	.085	.795	-1.004	1.977
x. This funding reduces an SME's financial distress	3.91	.092	.866	-.907	1.018
Average	3.97	0.086	0.807	-0.935	1.661

Table 5 shows an average mean of 3.97 for trade credit financing with standard error of .086. This shows that most respondents agreed with the ten statements highlighting the benefits associated with trade credit financing. With an average standard deviation of 0.807 showing that individual cases were still consistent with the mean as most respondents agreed with statements that outlined the gains associated with the application of trade credit as a form of financing to SMEs. The level of Skeweness was -0.935 (asymmetrical) and kurtosis of 1.661 which is closer to the mean. Munyonyi (2013) concurs with this findings when the study asserts that trade credit financing is a significant pointer on product quality which is one of the drivers of financial performance of SMEs.

Table 6: Financial performance of SMEs

Financial performance	mean	Std. Error	Std. dev.	Skeweness	Kurtosis
i. The SME realized higher output increasing gross profits	4.35	.061	.568	-.547	1.711
ii. The SME's costs reduced increasing business income	4.26	.059	.557	-.390	1.951
iii. The SME's net profits increased due to improved expenditure planning	4.28	.058	.546	-.369	2.129
iv. Reduction in taxation led to higher margins for the SME	4.25	.054	.509	-.201	3.056
v. Higher investment levels led to more revenue for SME	4.24	.064	.547	-.346	2.196
vi. Improvement in product quality led to higher sales	4.14	.067	.628	-1.245	6.245
vii. The SME acquired more assets improving their returns	4.16	.060	.623	-1.287	6.673
viii. Acquisition of current technology led to higher revenues	4.18	.066	.617	-1.333	7.166
Average score	4.23	0.061	0.574	-0.715	3.891

Respondents were asked to evaluate the financial performance of their enterprises with respect to profitability based on the statements and results in table 6 indicated that the average mean from responses on profitability was 4.23 with standard error of 0.061 which revealed that most respondents agreed with eight statements that alluded that most SMEs were performing well financially. With an average standard deviation of 0.574, the distribution was similar. The Skeweness of the data set was -0.715 (asymmetrical) and kurtosis of 3.891 which was larger than the mean hence a peaked distribution. This is consistent with Osoro and Muturi (2013) and Vo et al., (2011) when they claim that application of various funding channels resulted in improved financial performance of SMEs. Financial performance was felt in variables such as sales growth, profit, assets and better financial management among the SMEs.

Table 7: Correlation Matrix

		CLF	REF	TCF	Profitability
CLF	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	88			
REF	Pearson Correlation	.192	1		
	Sig. (2-tailed)	.073			
	N	88	88		
TCF	Pearson Correlation	.097	.354**	1	
	Sig. (2-tailed)	.371	.001		
	N	88	88	88	
Profitability	Pearson Correlation	.327**	.407**	.364**	1
	Sig. (2-tailed)	.002	.000	.000	
	N	88	88	88	88

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

Table 7 reveals a moderate, positive and statistically significant linear relationship between Commercial loan financing and financial performance of SMEs with a Pearson Correlation ratio (R) of 0.327 and a p-value of 0.002 ($p < 0.05$) at 95% confidence level. This shows that there is a linear relationship between commercial loan financing and financial performance. Application of commercial loan financing by SMEs affected their financial performance. Consistent to these findings, are results from (Munyuny, 2013) Eldoret municipality which indicated that there was a positive and significant correlation between long-term loan and profit margin ratio. Hence commercial loan financing was an important determinant of financial performance of SMEs in Lurambi Sub-County.

Results as indicated in table 7 indicates a moderate, positive and statistically significant linear relationship between retained earnings financing and financial performance with a Pearson correlation coefficient (R) of 0.407 and a p-value of 0.000 ($p < 0.05$) at 95% confidence level. This implies that, retained earnings financing have a significant positive effect on financial performance of SMEs in Lurambi Sub-County. They play a vital role in affecting financial performance of SMEs and their success is highly determined by how well they utilize this form of funding. Consistent with these results is (Akinbola&Otokiti, 2012) which found that lease option had significant correlation with organizational output and profitability in Lagos Nigeria. Inconsistent to these findings is (Njeru et al., 2012) in which correlations between firm size and SMEs choice of finance was not significant in Thika Kenya.

Results in table 7 indicated a moderate, positive and statistically significant linear relationship between trade credit financing and financial performance with a Pearson correlation coefficient (R) of 0.364 and a p-value of 0.000 ($p < 0.05$) at 95% confidence level. Hence trade credit has significant positive effect on financial performance of SMEs. Munyuny (2013) found that correlation between trade credit and profit margin was positive and significant for SMEs in Eldoret municipality in Kenya. The study still went on to establish a positive and significant relationship between trade credit and financial performance of SMEs in Eldoret municipality. Hence the strength of trade credit as a financing channel cannot be left un-underscored by both extant and this study.

Multiple Linear Regression Analysis

Regression tests were carried out to achieve the objectives under study from the data obtained regarding the extent to which respondents had agreed with the various statements concerning the independent and dependent variables. Multiple linear regression was carried out between sources of business financing (commercial loan financing, retained earnings financing and trade credit financing) and financial performance. The major purpose of this test was to ascertain the casual effect of independent variables on the dependent variable. The test was conducted in line with the objectives of the study. Results from the test were used to complete the discussion on the sources of business financing and financial performance of SMEs in Lurambi Sub-County.

Table 8: Summary of Regression Results

Goodness of fit				
R	R Square	Adjusted R Square	Std. Error of the Estimate	
.530 ^a	.281	.256	.38792	

Overall significance: ANOVA (F-test)

Model	Sum of Squares	Df	Mean Square	F	Sig.	
1	Regression	4.945	3	1.648	10.954	.000 ^a
	Residual	12.640	84	.150		
	Total	17.585	87			

a. Predictors: (Constant), Trade Credit Financing, Commercial Loan Financing, Retained Earnings Financing

b. Dependent Variable: Firm Performance

Individual significance

Model	Unstandardized Coefficients		Standardized Coefficients		T	Sig.
	B	Std. Error	Beta			
(Constant)	2.497	.313			7.984	.000
CLF	.125	.047	.251		2.658	.009
REF	.204	.075	.273		2.716	.008
TCF	.155	.063	.243		2.455	.016

a. Dependent Variable: Firm Performance

Table 8 shows that the independent variable (sources of business financing) is statistically significant in predicting financial performance of SMEs. With a coefficient of determination (R^2) of 0.281, the predictor variables influenced the dependent variable by 28.1%. Hence sources of business financing affected financial performance significantly at $F(3, 84) = 10.954$ and $p < 0.05$ at 95% confidence level as shown by table 4.11. Consistent with these findings is (Akinbola&Otokiti, 2012) which found that lease option affected the profitability of SMEs significantly in Lagos state in Nigeria. Also (Chepkemoi, 2013) capital structure significantly affected financial performance of SMEs in Nakuru Kenya; venture capital (Memba et al., 2012) was found to be an important component for SMEs' growth in Kenya. Hence the importance of sources of business financing to financial performance has been equally underscored by extant studies.

From table 8, regression analysis was performed and the betas examined to determine their strength, direction and significance of the relationship. All independent variables had positive and statistically significant predictive power. Results show that the partial correlation coefficient were as follows: commercial loan financing is 0.125, retained earnings financing 0.204, trade credit financing 0.155 and 2.497 is the constant (intercept). Hence the independent variables significantly affected financial performance of SMEs. Therefore the linear regression model becomes:

$$\mathbf{FinP} = 2.497 + 0.125(\mathbf{CLF}) + 0.204(\mathbf{REF}) + 0.155(\mathbf{TCF})$$

Where: **FinP**= financial performance

CLF =commercial loan financing

TCF = trade credit financing

REF= retained earnings financing

5.0 Conclusion

The main objective of this study is to examine the relationship between business financing variables such as commercial loan financing, retained earnings financing, and trade credit financing and firm performance among Small and Medium enterprises in Lurambi Sub-county Kenya.

Commercial loan financing has a positive effect on financial performance and this effect is statistically significant in predicting financial performance of SMEs. SMEs that use commercial loan financing will expand their business operations and experience significant increase in their profitability. The effect is moderate as these gains are dependent on the tradeoff (Joeveer et al., 2006) between high returns and costs including financing costs. Retained earnings financing has a positive and significant effect on financial performance of SMEs in Lurambi Sub-County. Application of trade credit financing by SMEs increases their business activities resulting in high level of profitability which lead to a significant improvement in financial performance. SMEs would continually turn to retained earnings financing (Stepanyan, 2012) to hedge them against the rising cost of financing and improve their profitability in order to realize growth and sound financial performance.

Trade credit financing has a positive and significant effect on financial performance of SMEs. It therefore follows that trade credit is a significant predictor of financial performance. SMEs that use trade credit in financing their operations are likely to see their output and revenues increase thus increasing their level of

profitability. The combined effect of sources of business financing variables and financial performance was positive and statistically significant. SMEs that utilize sources of business funding channels such as commercial loan financing, retained earnings financing and trade credit would definitely perform well. They are critical in determining financial performance SMEs hence enabling them move to the next growth level.

Recommendations

On the basis of the foregoing conclusions, the study presents the following recommendations to the SMEs business community, policy makers, lenders and scholars for review and consideration. Investors and managers of SMEs should consider sources of business financing as important determinants of financial performance. SMEs should come together to form larger groups in order to access bigger commercial loans from banks, microfinance institutions and other lenders which are cheaper to source as they carry lower transaction costs and such costs are shared by SMEs in the group reducing its impact on individual SME's financial performance. Government agencies engaged in availing funds to SMEs should avail such funds at the lowest possible rate or otherwise provide them at zero interest rate for the SMEs to realize sustained and robust financial performance. The Kenyan Government funding programmes for SMEs such as the Women enterprise Fund, Youth Development Funds and the Uwezo Fund should be tailored to meet individual SME borrower's needs besides the current group affiliation focus in order to improve the reachability and accessibility of the funds to many needy business operators. The Kenyan and County Governments should step in to act as guarantors of commercial loans obtained by SMEs from lenders as this will ensure that the SMEs experience sound and sustainable financial performance.

The Kenyan Government through the Central Bank of Kenya (CBK), should make it mandatory for banks and lenders to revise their lending rates annually in tandem with CBK revisions and set a ceiling within which these rates should lie to make commercial loans cheaper to SMEs borrowers. For instance the Central Bank could demand that no lender should add a risk premium of more than 2.5% on top of the prevailing Kenya Bankers' Reference Rate (KBRR) and violators of this rule are highly penalized. The Government of Kenya (GOK) should encourage financial institutions to share the financing risks between themselves and the Government in order to make commercial loan financing have a greater significant contribution to financial performance of SMEs. SMEs should honor their trade credit terms at their last date of terms so that they benefit from relevant discounts and negotiate for longer discount periods in order to realize significantly higher levels of financial performance.

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