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# FACTORS AFFECTING ACCESS TO CREDIT BY MICROENTERPRISES IN GAROWE, PUNTLAND

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**Abstract**

*In developing countries, despite the efforts by various stakeholders, lack of access to credit is almost universally indicated as a key problem facing MSE's. The main objective of the study was to evaluate factors affecting access to Micro Finance by Micro Enterprises. The researcher also set out to establish the influence of collateral requirements on accessibility of credit facilities by MSEs, determine the influence of cost of credit on accessibility of credit facilities by MSEs, The study used quantitative and comparative research design. This study used firstly purposive sampling in selecting enterprises market, and then cluster sampling to determine enterprises in each zone, and finally used systematic sample for determining the study respondents. This study collected quantitative data on the challenges affecting factors affecting access to micro finance by micro enterprises and financial institutions using a questionnaire. In addition, the study found out that the collateral requirement is very high, while accessing to credits. This is because of the banks are willing to reduce the risk of losing their loan and as well as the study found out that the cost of credit is one of the major factors, which are constraint to access to microfinance by enterprises in Garowe, Puntland. However, the study recommends that Microfinance institutions should simplify the collateral requirements in order to increase the accessibility to microfinance by micro enterprises. The study recommends that Micro finance institutions and banks should reduce their bank's profit charge of which they charge to micro enterprises. The study also recommends strengthening the other processing system and* *minimizing the charge to the loans. The study recommends that micro enterprises reduces the competitions, which are threat to their counter parts and maintain the proper competition, which have positive impact to other micro enterprises. The study also recommends that Government, particularly the Ministry of commerce should issue a related policies including competitions, which guides the micro enterprises and supervises how they implement the policies as per required.*

*Keywords: Collateral Requirement, Cost of Credit, Availability of Information on Finance, Business risks*

## INTRODUCTION

Micro and Small Enterprises (MSEs) are lifeblood of most economies. To be successful in this and other business sectors, finance plays a major role. As far as MSEs are concerned as part of business enterprises, they need finance to start up, expand, diversify and for working capital of the business firms. Without finance, no one business enterprise can achieve its objectives. Finance is the backbone of MSEs and any other business enterprise (Mckernan & Chen, 2015). Both in the developing and developed world small firms have been found to have less access to external finance and to be more constrained in their operation and growth (Galindo & Schiantarelli, 2013).

Micro, Small and Medium Enterprises (MSMEs) are viewed as a key driver of economic and social development in the African context. They represent a large number of businesses in a country, generate much wealth and employment and are widely considered to be vital to a country's competitiveness. MSMEs are hailed for their pivotal role in promoting grassroots economic growth and equitable sustainable development (Pelham 2000). MSMEs tend to be large in number, accounting for about 90 percent of all enterprises in many African countries and over 80 percent of new jobs in a given country (Reinecke, 2012).

The financial system in most of Africa is under-developed however and so provides few financial instruments. Capital markets are in their infancy, shareholding is rare and no long-term financing is available for MSEs. Non-bank financial intermediaries, such as microcredit institutions, could be a big help in lending money to the smallest MSEs but they do not have the resources to follow up their customers when they expand (Kauffmann, 2005).

Recognizing the critical role small businesses play in the Kenya economy, the Government through Kenya Vision 2030 envisages the strengthening of MSMEs to become the key industries of tomorrow by improving their productivity and innovation (Ministry of Planning, National Development & Vision 2030 [MPNDV2030], 2007). However, it is generally recognized that MSMEs face unique challenges, which affect their growth and profitability and hence, diminish their ability to contribute effectively to sustainable development. The International Finance Corporation (IFC) (2011) has identified various challenges faced by MSMEs including lack Of innovative capacity, lack of managerial training and experience, inadequate education and skills, technological change, poor infrastructure, scanty market information and lack of access to credit.

The catalytic roles of micro and cottage businesses have been displayed in many countries of the world such as Malaysia, Japan, South Korea, Zambia, and India among other countries. They contribute substantially to the Gross Domestic Production (GDP), export earnings and employment opportunities of these countries.

MSEs have been widely acknowledged as the springboard for sustainable economic development (Osotimehin, Jegede, Akinlabi, & Olajide, 2012). Apart from the fact that it contributes to the increase in per capital income and output, it also creates employment opportunities, encourage the development of indigenous entrepreneurship, enhance regional economic balance through industrial dispersal and generally promote effective resource utilization that are considered to be critical in the area of engineering economic development (Oboh, 2004; Odeh, 2005).

The MSEs play a key role in triggering and sustaining economic growth and equitable development in both developed and developing countries. According to Government of Kenya Sessional Paper No.2 of 2005 on Development of MSEs cut across all sectors of the country's economy. They also provide one of the most prolific sources of employment, not to mention the breeding ground for entrepreneurs in medium and large industries, which are critical for industrialization. The exploitation of the potential of the indigenous sector as an engine for growth, using local resources and appropriate technology which is the nature of MSEs, is seen as an alternative development model to the traditional large-scale intensive "stages of growth" paradigm in developing economies (OECD, 2004). The MSE sector in Africa is a vibrant example of small enterprises activities leading to successful growth and development of African economies (Hope, 2001).

Despite their significance, past statistics indicate that 3 out of 5 businesses fail within the first few months of operation and those that continue 80 per cent fail before the fifth year (Kenya National Bureau of Statistics, 2007). This menace is attributed to poor financial management among small businesses. Accessing credit is a major constraint to the development and growth of MSEs and also to poor rural and urban households. This is mainly due to the behavior of lenders in terms of hedging against borrowers' risks by demanding collateral, which they lack, and also information asymmetry. Consequently borrowers who are willing to pay prevailing credit interest rates cannot access the funds at those rates because lenders are unwilling to lend to them due to dearth of information about them and lack of collateral sable assets, severely constraining their access to credit. This behavior is common amongst formal financial institutions. Evidence shows that such borrowers may then be forced to limit their investments to retained earnings (International Finance Corporation, 2000) thereby restricting enterprises growth and development.

A crucial element in the development of the MSE sector is access to finance, particularly to bank financing, given the relative importance of the banking sector in serving this segment. Firm-level data collected by the World Bank show that access to finance is perceived as one of the main obstacles to doing business. A number of studies have shown that financing is a greater obstacle for MSEs than it is for large firms, particularly in the developing world, and that access to finance adversely affect the growth of the MSE sector more than that of large companies (Schiffer, &Weder, 2001; Beck, T., Demirgüç-Kunt, &Maksimovic, 2005). It is, therefore, unsurprising that the international development community has listed small and micro enterprises (SMEs) access to finance as an important policy priority.

Africa's MSEs have little access to finance, which thus hampers their emergence and eventual growth. Their main sources of capital are their retained earnings and informal savings and loan associations, which are unpredictable, not very secure and have little scope for risk sharing because of their regional or sectoral focus. Access to formal finance is poor because of the high risk of default among MSEs and due to inadequate financial facilities. Small businesses in Africa can rarely meet the conditions set by financial institutions, which see MSEs as a risk because of poor guarantees and lack of information about their ability to repay loans. So this study was To Evaluate Factors Affecting Access to Micro Finance by Micro Enterprises in Garowe, Puntland.

**Specific objectives**

i. To establish the influence of collateral requirements on accessibility of credit facilities by MSEs in Garowe, Punt land-Somalia;
ii. To determine the influence of cost of credit on accessibility of credit facilities by MSEs in Garowe, Punt land-Somalia
iii. To investigate the influence of availability of information on accessibility of credit facilities by MSEs in Garowe, Puntland, Somalia.
iv. To establish the influence of business risks on accessibility of credit facilities by MSEs in Garowe, Puntland, Somalia

## LITERATURE REVIEW

### Credit Rationing Theory

According to Keiding (2013) the financial institutions are mostly private entities which are guided by profit maximization objective. Contrary to this objective not all individuals who apply for financing are granted access. Thus the market for credits is not balanced through the price mechanism. Individuals may be denied credits even if they are willing to pay arbitrarily high interest rates. De Meza and Webb (1987) states that the credit market is not like the normal market where demand is equivalent to supply as the borrowers who are willing to pay higher interest rates may find it difficult when it comes to repayments.

Credit rationing is defined as a situation in which there is an excess demand for commercial loans at the prevailing commercial loan rate (Stiglitz and Weiss 1981, and Modigliani, 1969). They further identify two types of credit rationing: 1. *Pure credit rationing:* Occurs when some individual's gets loan while at the same time identical individuals with the same characteristics do not get. The identical individuals are vying at the same credit and non-credit terms; 2. *Redlining:* a situation that occurs when an identifiable group of individuals cannot access a given supply of credit at whichever rate of interest unless the credit supply is increased.

The scenario arises due to the fact according to Hodgman (1960), the borrower would be unable to repay the loan due to the increased interest rates. That is the cost of borrowing would turn out to be higher than the return on investment. Due to the cost of the loan the lender may desist from lending to a borrower who demands for credit when the interest rates are higher. With time this view was abandoned when Weiss and Stiglitz developed a better explanation where they related credit rationing to the information asymmetry that exists within the actors in the financial markets.

### Market Failure Theory

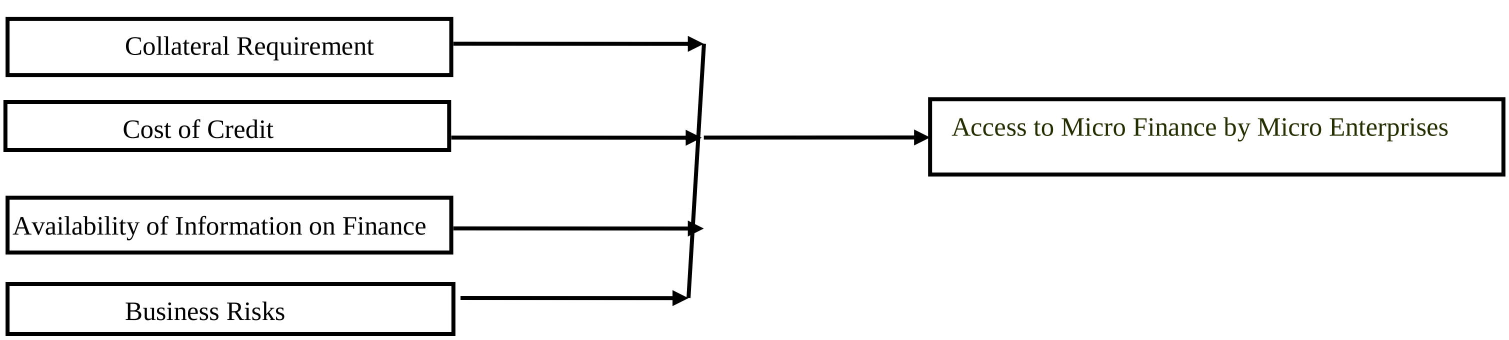
The proper role of banks and microfinance institutions as a starting point for the analysis of MSME‟s financing should be approached in light of establishing their limiting factors. The following theory justifies the reason behind the inefficient supply of finances to MSME‟s in the market. According to private market efficiency theory as discussed by Mendes (2004) posits that under certain circumstances private markets will allocate goods and services among individuals efficiently in the sense that no waste occurs and that individual tastes are matching with the economy's productive abilities. The hue and cry of MSME‟s seems to point to failure of MSME‟s in meeting all the requirements‟ as the policy of lending in financial institutions stipulates. Banks and MFIs most of them being private entity's do try and are able to provide efficient outcomes and if the MSME‟s were providing the right atmosphere, then there would be little or no scope of lack of finances. In many cases, however, conditions for private market efficiency are violated from the demand side through factors like information asymmetry, lack of clear risk management policy among others.

According to Marlow (1995) while discussing market failure theory he put it that under ideal conditions related to competition, information and the absence of externalities, private competitive markets allocate resources efficiently. For financier (debt and equity providers) to play a legitimate role the ideal conditions must be present and efficiency must be the most important criterion for directing resource allocation. "Market failure" occurs therefore when financial service providers in the markets do not allocate goods or services efficiently. The existence of market failure provides an efficiency-based rationale for concluding that MSME‟s are being limited in access to finance.

### Information Asymmetry Theory

This theory was first introduced by Akerlof‟s in 1970. His argument was that in many markets the seller uses some market statistics to measure the value of the goods he is selling. In this scenario of the credit market the buyer sees the average prices of the loans (credit) in the market he is intending to buy while the seller has more intimate knowledge of each specific loan product. According to Akerlof (1970) this puts the seller at a more advantage thus able to sell goods of less than average market quality. In such circumstances the limitation of the information available to the buyer may lead to the seller offering less than average quality of goods in the markets which eventually leads to reduction in size of the market. Information asymmetry theory assumes that at least one party to a transaction has relevant information whereas the other(s) do not. Some asymmetric information models can also be used in situations where at least one party can enforce, or effectively retaliate for breaches of, certain parts of an agreement whereas the other(s) cannot. Spence & Stiglitz (2001) demonstrated that market may break down completely in the presence of asymmetric information and the three distinct consequences emerging, adverse selection, moral hazard, & monitoring cost.

Figure 1. Conceptual Framework



## Review of Variables

### *Collateral Requirement*

Historical development and the associated culture, of the banking system underpin the problem of the emphasis on the provision of collateral as a primary condition in lending. Banks have always adopted a risk adverse stance towards small firms, with an accompanying inability to focus on the income generating potential of the venture, when analyzing the likelihood of loan repayment (Beaver, 2012).

Credit constraints can occur when banks increase collaterals for loans. As a result, low interest borrowers (including MSEs) may be removed from the list of potential customers and banks may skip these customers (Stiglitz& Weiss, 1981).Gangata &Matavire, (2013) in their study on challenges facing MSEs in accessing finance from financial institutions, found out that very few MSEs succeed in accessing funding from financial institutions, the main reason being failure to meet lending requirements, chief among them being provision of collateral security.

A study was done on challenges faced by Small & Medium Enterprises (SMEs) in obtaining credit in Ghana. Based on the responses received through the questionnaires circulated, it became evident that SMEs in Ghana like most SMEs in other countries are faced with major challenges in accessing credit. These challenges were revealed by the study to include, the inability of SMEs to provide collateral and other information needed by banks such as audited financial statement couple with the high cost of loan in terms of high interest rates make it extremely difficult to access bank loans (Vuvor&Ackah, 2011).

Cressy and Toivanen (2001) say that, "better borrowers get larger loans and lower interest rates; collateral provision and loan size reduce the interest rate paid the bank is shown to use qualitative as well as quantitative information in the structuring of loan contracts to small businesses." In effect, it may therefore be that simple because banks approach the lending process in a risk-averse way (in order to protect the funds of savers), and thus turn down a number of propositions perceived to be 'riskier', that there is an apparent 'discrimination' against for example women and ethnic minorities

### *Cost of Credit*

The cost of credit accessibility refers to the amount of money the entrepreneurs pay in process of borrowing money from financial institutions. The key indicators of cost in this respect are processing fees, negotiation fees, interest rates; personal insurance, legal fees band travelling expenses that the entrepreneurs meet in the process of acquiring credit. Hallberg, (2002) singled out high risks associated in lending SMEs and fixed costs associated in acquiring sound information about the borrower by financial institutions as the major driving force to the high cost of credit.

High transaction costs do therefore not only increase the cost of borrowing, but can also restrict access to external finance for some borrower groups. While transaction costs are restraining for all borrowers, there are arguments that they are even more constraining for small and micro enterprises. Their diverse characteristics and their relative opaqueness increases assessment and monitoring costs. Unlike other credit categories, such as consumer credit or mortgage lending; SME lending is still considered a high-cost lending product. More specifically, unlike other lending products that can be reduced to simple transactions, SME lending often still depends heavily on relationships between borrowers and lenders (Berger&Udell, 2006)

Every business needs financing, even though at first glance it might appear that funding is unnecessary. It is important that financing be as efficient as possible, Stutely (2003). Stutely, argues that the borrower should be able to put the cost of all financing on the same basis, comparing them and come up with the one that gives the lowest cost financing option. Banks have often been criticized for having high interest rates charged on loans. But sometimes, there are factors beyond their control. For example, the amount of interest payable on loans depend on interest rates charged, which is driven by the base lending rate of interest set by the Central Bank of Kenya (CBK).

The amount of interest rate charged is sometimes, intertwined with the security of the loan, and the use for which it is to be used, or the nature of the business. That is, the more secure loans are charged low interest rates due to, their low risks involved. This leads MSEs to the Micro Finance Institutions (MFIs), who lend unsustainable interests short term loans. A study carried out by Mwangi and Bwisa, (2013) on challenges facing entrepreneurs in accessing credit: a case of youth entrepreneurs in Makuyu, Kenya found out that most of youth entrepreneurs faced challenges in accessing credit due high cost of credit evidenced in high loan processing fees, high rate of legal fee, high rate of interest, high cost of credit insurance and high expenses incurred in travelling in the process looking for credit.

The research recommends that the financial institutions should look for ways of developing credit products that would attract the youth. The lenders and other stakeholders should explore lowering rate of interest for credit products meant for the youth. Another study was done one effects of access to financial credit on the growth of women owned small retail enterprises in UasinGishu County: a case of Kapseret Constituency. The study found out that interest rates affected access to credit by women entrepreneurs owning small scale business enterprises in Kapseret Constituency (Cheluget, 2013).

### ***Business Risk***

Risk factor is another aspect that explains the access to credit facilities by MSEs. Total risk (both business and financial risk) may be a dimension across which a financing gap might exist. A firm's business risk (which focuses on a firm's operations), represents the uncertainty of the firm's return on its assets (Correia, Flynn &Wormald, 2008). Whereas, financial risks occurs when a firm makes use of debt (that is, financial leverage). In such instances, the firm takes on additional responsibility of financing the debt which is paying interest payments on time. The inability of the firm to pay the interest payments or repay the principal will result in a default that might lead to bankruptcy. As the amount of debt used by the firm increases, the chances of it defaulting will also go up due to constraints on its cash flows as a result of the interest payments. MSES rely more on external financing, thus the financial risk in the MSE sector is most likely to be very high.

Green (2003) argued that commercial banks tend to impute a high risk to small enterprises and are therefore reluctant to extend credit to them. Due to their small size and inherent vulnerability to market fluctuations, the mortality rates of small enterprises are relatively high. These firms are, by their very nature, often relatively young and consequently lack a financial history and a track-record of profitable projects. In addition, organization and administrative deficiencies, lower quality management and a lack of appropriate accounting systems may compromise the accessibility and reliability of information from small firms on their repayment capacity.

The difficulties faced by MSEs in accessing credit facilities are attributed to their perceived higher risk profile. Lending institutions regard MSEs as riskier enterprises for a number of reasons which include: uncertain competitive environment; inadequate accounting systems; more unpredictable operating environment in the developing and emerging markets; assets not properly registered; delayed payments for the products and services rendered; less equipped in terms of both human and financial resources to withstand economic resources (Van Aardt &Fatoki, 2012).

### ***Availability of Information on finance***

The access to credit information and the technology in local lending environments determine the extent to which small enterprises obtain sufficient external financing to exploit profitable projects. The extent to which the business environment inhibits the optimal provision of credit determines the size of the funding gap that small enterprises might face (Berger et al., 2004). Access to information is important both from the MSEs perspective and from the perspective of the providers of financial services and products.

The MSE requires information with which to identify the potential suppliers of the financial products. It requires this information to evaluate the cost of the financial services and products that are being offered. The financial service providers require information with which to evaluate the risk of the MSE which is applying for finance, and to assess the prospects of the MSEs within the market segment.

One of the problems faced by small firms when attempting to raise finance is information asymmetry in that they cannot prove the quality of their investment projects to the provider of finance (usually banks). Small firm managers often suffer from a lack of financial sophistication, as they are often product or service specialist, not specialists in the area of finance. Thus, the information asymmetry problem is partly one relating to difficulties in the spheres of communication and credibility. This is compounded by the fact that new or recent start-ups businesses may be unable to provide evidence of a good financial performance track record. Banks in particular rely on past financial performance as an indicator for the future profitability of projects (Tucker & Lean, 2003). Access to information is therefore a basic condition for providing loans to firms. Often the problem of inadequate information is mentioned as one of the main aspects limiting bank finance to MSEs (Observatory of European SMEs, 2003; Udell, 2004).Most of the information banks obtain from MSE operators come from the borrowers themselves: investment plans, working capital requirements and balance sheets. The required information is then scrutinized for internal consistency, and compared to other information the bank has at its disposal. However, interaction with the borrower is the next possible source of information for the bank from the MSE Borrowers. By handling the borrower's accounts, the bank knows the borrower's volume of transaction and the trend of his/her business. As a result borrowers are most likely to obtain loans and overdraft facilities from a bank that they have been banking with for years.

According to the Observatory of European SMEs (2003:23), 60% of the SMEs in Europe regularly provide this type of information. The report further indicates that there is a positive correlation between the size of the enterprise and the information provided to banks.

It further indicates that 70% of the SMEs without credit lines do not share financial information with the bank. The situation is even worse in the lesser developed countries where the level of literacy is dismally low. However, provision of information to the bank may be a necessity for creating a rating culture among MSEs for purposes of accessing external finance. Small business owners most often possess more information about the potential of their own businesses but in some situations it can be difficult for business owners to articulate and give detailed information about the business as the financiers want. Additionally, some small business managers tend to be restrictive when it comes to providing external financiers with detailed information about the core of the business, since they believe in one way or the other, information about their business may leak through to competitors (Winborg&Landstrom, 2000).The importance of keeping proper accounts in promoting the growth of small businesses has been acknowledged in prior studies on small business growth and development (Abor &Biekpe, 2006,). Kinyanjui, (2006) records that some entrepreneurs felt that it was difficult to obtain loans as they had to show credit records and they did not fully understand the requirements of getting and paying loans.

## Empirical Review

### *Access micro credit*

Access to external sources of finance may increase growth possibilities since it facilitates the development and improvement of firm's products and services or hire new employees. In transition economies, the development that financial markets experience may create barriers linked to the access to finance. Hence, academic research considers financial constraints as an important obstacle for entrepreneurship and firm growth. Empirical evidence supporting the importance of access to external finance for business growth can be found in Brown, Earlem&Lup,(2005), who examines firm growth determinants. Conversely, Johnson, McMillan and Woodruff (2000) evaluate institutional reforms in five Eastern European countries (including Romania), and they conclude that access to bank finance does not prevent business growth.

Lack of access to credit facilities is almost universally indicated as key problem for small and micro enterprises. In most cases, even where credit is available mainly through banks, the entrepreneurs may lack freedom of choice because the banks' lending conditions may force the purchase of heavy, immovable equipment that can serve as collateral for the bank. Credit constraints operate in variety of ways in Kenya where undeveloped capital market forces entrepreneurs to rely on self-financing or borrowing from friends and relatives. Lack of access to long-term credit for micro, small and medium enterprise forces them to rely on high cost short term finance (Wanjohi&Mugure, 2008).

Matavire et al., (2013), in their study on challenges facing SMEs in accessing finance from financial institutions: The case of Belaway, Zimbabwe found out that SMEs fail to secure loans because of restrictive requirements of the financial institutions, top among them being collateral security. Among their recommendations is that the government should play its role of enabling SMEs to obtain finance from financial institutions. Makena, et al., (2014), in their study on challenges facing women entrepreneurs in accessing business finance in Kenya: Case of Ruiru Township, Kiambu County, lack of collateral was one of the objectives. However, the study found out that lack of collateral was a greater hindrance to credit accessibility by women entrepreneurs. This is due to lack of tangible assets like land, which are used as assets to secure credits. Among their recommendations is that the government should play its role of enabling SMEs to obtain finance from financial institutions.

Gitari, (2012) in her study on factors affecting women entrepreneurs' financial performance in Kenya: a case of Ngara Market found out that lack of information on who is offering what and the cost of obtaining such services limit them and that high inventory costing are some of the major drawbacks for success in women entrepreneurship. The high cost of running the entrepreneurs is a big threat to the women development due to lack of adequate capital and on the other hand lack of information on how to access funds to boost the business also is a major threat. Ntakobajira, (2013), did a study on factors affecting the performance of MSEs traders at City Park hawkers market in Nairobi County, Kenya. The study concluded that access to finance affected performance of MSEs to a great extent because it limited the entrepreneurs' ability to take advantage of opportunity as and when they aroseAnother study was done which sought to identify critical factors that influence access to bank credit by MSEs. The study indicated that entrepreneurial orientation is a direct determinant of access to credit by MSEs. Further, knowledge-based resources gained from maturation (age), training, previous startup experience and vicariously through entrepreneurial parents were found to be associated with greater levels of entrepreneurial orientation.

Overall, these findings support the literature that underscores the primacy of entrepreneurial factors, over operating environment in facilitating small enterprises' access to bank credit (Wagema, 2006). Nalyanya, (2012) in his study on investigation into factors affecting the performance of small scale enterprises in ASAL areas Hola Town – Tana River District, recommended that the government could consider giving cheap loans to small scale enterprises without collaterals.

## RESEARCH METHODOLOGY

### Research Design

The study used quantitative and comparative research design. Quantitative approach relies on the principle of verifiability, that is, confirmation, proof, corroboration or substantiation. It is applicable where the researcher incorporates the statistical element designed to quantify the extent to which the target group is (or thought or believed to be) aware of, or is inclined to behave in a certain way. It was also applicable when frequencies are required to explain meanings, thus necessitating the collection of numerical data in order to explain certain phenomenon. Finally, it was useful when data analysis were mainly statistical

### Target Population

A population is the whole group that the research focuses on (Kothari, 2012). It was the total number of respondents, or the total environment of interest of the researcher (Oso& 66 Onen, 2009). The total study population or the respondents was 200 (Garowe Municipality, 2016**)**. The targets of this study were the small business enterprises. The small businesses will be heterogeneous in terms of nature and legal status.

### Sample and Sampling Technique

This study used firstly purposive sampling in selecting enterprises market, and then cluster sampling to determine enterprises in each zone, and finally used systematic sample for determining the study respondents.

Systematic sampling by determining the n th respondent using record provided by the Garowe Municipality. 200/133 = Every 2$^{th}$ respondent.

*Determining Sample Size*

Sloven's Formula:

$n = N/(1+N(0.05^2))$

n; Sample number

N; Population number

Table 1. Sample Size

| No | Area | Population | Sample | Percentage |
|---|---|---|---|---|
| **1** | Inji Market Zone A | 82 | 55 | 41 |
| **2** | Inji Market Zone B | 53 | 35 | 27 |
| **3** | Inji Market Zone C | 65 | 43 | 32 |
| **TOTAL** | | **200** | **133** | **100** |

Source: Garowe Municipality, 2016

### Data and Data Collection Procedure

This study collected quantitative data on the challenges affecting factors affecting access to micro finance by micro enterprises and financial institutions using a questionnaire. A questionnaire is a collection of items or questions to which a respondent is expected to react or answer, usually in writing (Oso&Onen, 2009).

The questionnaire was "close ended" with an element of "Likert Scale" (see appendix 1). A questionnaire was chosen as the research instrument for this study because it is a suitable tool where the population is literate and the information needed can be easily described in writing (Oso&Onen, 2009). The population for this study was literate and the information required is of the nature that was easy to describe in writing. It was also chosen because questionnaires have a number of advantages. According to Kombo and Tromp (2006), as a research instrument, a questionnaire gathers data over a large sample. For instance data can be collected from a large sample and diverse regions and confidentiality is upheld. Using a questionnaire also saves time and, since they are usually presented in paper format, there is no opportunity for interviewer bias. However, questionnaires have some disadvantages in that the response rate can be low. Because in many cases there is no direct contact, it is difficult for the researcher to deal with misunderstanding. Likewise, there is no opportunity to seek clarifications or further information related to the answers given. To overcome these weaknesses, where practically possible, the researcher sits in as the respondent filled in the questionnaire and is, therefore able to clarify any issues.

This study collected quantitative data. Before going to the field, the researcher secures appointments with the respondents. Data was collected using a self-administered questionnaire. The questionnaire is self-administered because all the respondents were all literate, experienced and conversant with the issues surrounding the factors affecting access to micro finance by micro enterprises (Mugenda&Mugenda, Kothari, 2004; Oso&Onen, 2009). Since the researcher was usually present as the respondent filled in the questionnaire, he promptly clarifies any questions that are not very unclear to the respondent. Where it proved difficult for the respondents to complete the questionnaire immediately, the researcher left it with the respondents and tells them when he would pick them up.

**Pilot Testing**

Pilot testing is the process of pre-testing the questionnaire with a small representative sample aimed at identifying potential misunderstandings or biasing effects of different questions and procedures (Kang'ethe*et al.*, 2008; Pallant (2007), and Nicol and Pexman (2010). The data collection instrument for this study will pre-test using a small sample of Micro finance accessibility by micro enterprises, but which is not included in the study sample. The pre-testing will help to point out questions that are difficult to understand, those that could be interpreted differently by different people, as well those that were similar. After the pre-testing, improvements will be made on the instruments and the final copies will produce.

**Data Analysis and Presentation**

Different data was analyzed as follows descriptive statistics based on frequency counts, complex tables and percentage distributions will be to determine the information on demographic variables of the respondents.

Descriptive statistics based on means and standard deviations will be used to determine the levels of access to microfinance. The inferential statistics will be used to distinguish factors affecting access to microfinance

Data entry, storage and analysis will do with the aid of Scientific Package for Social Sciences (SPSS). After data collection, all the questionnaires will be coded as part of the data cleaning process. The aim here is to eliminate unusable data. A coding scheme covering responses to all the questions will be developed. The coding scheme will facilitate the development of an appropriate data structure to enable its entry and storage in the computer, in readiness for its analysis. After all the data will enter into the computer, it will be checked and corrected for any errors. After this editing the data is ready for analysis.

## RESULTS AND DISCUSSION

Table 2. Age Distribution

| Class | Frequency | Percent |
|---|---|---|
| **18-24** | 12 | 7.5 |
| **25-30** | 42 | 35 |
| **31-35** | 27 | 22.5 |
| **36-40** | 18 | 15 |
| **41-45** | 10 | 5 |
| **46-50** | 12 | 7.5 |
| **50 +** | 12 | 7.5 |
| **Total** | 133 | 100 |

Table 2 reveals that the study examines and describes the respondents' age distribution; respondents were mainly aged between 25-30 years (35%) with only22.5% being 31-35 year. This shows that Most of the respondents are at level of youth and have bright ideas to continue their businesses. This is necessary and shows that the small business enterprises will take part the employment opportunities.

Table 3. Level of Education

| | Frequency | Percent |
|---|---|---|
| Literate | 23 | 12.5 |
| Primary/informal education | 40 | 37.5 |
| Secondary | 34 | 22.5 |
| Collage/University | 36 | 27.5 |
| Total | 133 | 100 |

As Table 3 shows, academically, primary education was the dominant qualification among the respondents, with 38% of them being in this category. 28% of the respondents had a college qualification with 13% having no academic qualification at all. In analyzing the respondents' characteristics, this reveals that most of Micro enterprise owner or employees have basic education of recording and keeping their properties.

Table 4. Number of Years in Business

| | Frequency | Percent |
|---|---|---|
| Less than 1 year | 27 | 17.5 |
| 1-5 years | 55 | 50 |
| 6-10 years | 27 | 17.5 |
| more than 10 years | 21 | 15 |
| Total | 130 | 100 |

In Table 4, Most of the enterprises (50%) had been running for between 1-5 years, with other having worked for more than 10 years (15%) and 18% having worked for less than a year. This indicates that most of the business enterprises have enough experience to run the business, which results to be successful and profitable.

Table 5. Descriptive Statistics of Effect of Collateral Requirement on Access to credit

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Group guarantees | 133 | 1 | 5 | 3.90 | 1.277 |
| Individual guarantors | 133 | 1 | 5 | 2.65 | 1.388 |
| Title deeds | 133 | 1 | 5 | 3.55 | 1.108 |
| Log books | 133 | 1 | 4 | 2.88 | 1.305 |

In table 5 are details of the effects of collateral requirement on access to credit under different key statements obtained from the respondents. The statements have been ranked in terms of their means and standard deviations so as to deduce meaning out of the results.

Table 6. Descriptive Statistics of Statement of Collateral Agreement

| | N | Min | Max | Mean | Std. Deviation |
|---|---|---|---|---|---|
| The collateral requirement is too high | 133 | 3 | 5 | 4.45 | .639 |
| The amount of credit given as a percentage of value of collateral is too low | 133 | 1 | 5 | 3.47 | 1.132 |
| Valid N (listwise) | 133 | | | | |

In the Table 6, the researcher set out to examine the Statement of Collateral Agreement as a way of examining the functionality of the Collateral agreement. The statements were equally ranked in terms of their mean and standard deviation as a way of interpreting the results.

Table 7. Descriptive Statistics of Statement of Cost of Credit

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| The legal fees charged are too high | 133 | 1 | 10 | 4.02 | 1.941 |
| The credit processing is too high | 133 | 1 | 7 | 3.60 | 1.215 |
| Valid N (listwise) | 133 | | | | |

In the table 7, the researcher set out to examine the Statement of Cost of Credit on access to credit**.** The results were analyzed used mean and standard deviations so as to drawing conclusions from the survey

Table 8. Descriptive Statistics of the influence of business risks on accessibility of credit facilities by MSEs

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Competitive of business | 133 | 1 | 5 | 4.18 | .984 |
| Accountability of Business | 133 | 1 | 5 | 2.65 | 1.511 |
| business is prone to the stability of the country | 133 | 1 | 5 | 3.00 | 1.155 |
| Valid N (listwise) | 133 | | | | |

In the table 8, the researcher set out to establish the influence of business risks on accessibility of credit facilities by MSEs. The results were analyzed used mean and standard deviations so as to drawing conclusions from the survey. The results are discussed under the various headings of the statements tested

Table 9. Correlation on Access to finance and Collateral

| | group guarantees | Indiv. guarantors | Title deeds | Log books. | Collat high | Amt low | Access to fin. |
|---|---|---|---|---|---|---|---|
| **group grantees** | 1.0000 | | | | | | |
| **Indiv. grantors** | -0.1771 | 1.0000 | | | | | |
| **Title deeds** | 0.3056*** | 0.15045*** | 1.0000 | | | | |
| **Log books** | 0.5764*** | -0.4526 | 0.4748*** | 1.0000 | | | |
| **Collat high** | 0.0927 | 0.17805*** | -0.5308*** | -0.2519 | 1.0000 | | |
| **Amt low** | -0.1755 | -0.0517 | -0.3786 | -0.3114 | 0.3551*** | 1.0000 | |
| **Access to fin.** | 0.2240*** | 0.0425 | 0.0437 | -0.2986 | -0.0964 | 0.3506*** | 1.0000 |

*** (P=0.05), ** (0.01) and *(-0.1)

A spearman's rank correlation coefficient was also used to test for correlation between access to finance and the nature of collateral. This included calculations of the spearman's rank correlation coefficient ($\rho$) between being access to credit and the four types of collateral , and access to credit and perception on the collateral value as well as the amount of credit Correlation coefficients were also calculated between the independent variables themselves.

Table 10. Chi square test of independence between Access to finance and Collateral

| | $\chi^2$ Value | Degrees of freedom (df) | p-value |
|---|---|---|---|
| **group grantees** | 36.22 | 16 | 0.002697 |
| **Indiv. Grantors** | 24.329 | 16 | 0.08256 |
| **Title deeds** | 21.974 | 16 | 0.144 |
| **Log books** | 49.695 | 12 | 1.58e-06 |
| **Collat high** | 23.407 | 8 | 0.002879 |
| **Amt low** | 36.182 | 16 | 0.00273 |

Table 11. Correlation on access to credit and cost of credit

| | High legal fees | High cr.prcss | High bnkprft | Access to fin. |
|---|---|---|---|---|
| **High legal fees** | 1.0000 | | | |
| **High cr. process** | 0.6412*** | 1.0000 | | |
| **High bank profit** | 0.0712 | 0.3554*** | 1.0000 | |
| **Access to fin.** | 0.0136 | -0.4084 | -0.4426 | 1.0000 |

*** (P=0.05),

A spearman's rank correlation coefficient was also used to test for correlation between access to finance and the nature of costs above. This included calculations of the spearman's rank correlation coefficient ($\rho$) between being access to credit and the ranks on amount of cost. Correlation coefficients were also calculated.

Table 12. Chi square test of independence between Access to finance and Collateral

| | $\chi^2$ Value | Degrees of freedom (df) | p-value |
|---|---|---|---|
| **Where credit** | 27.833 | 16 | 0.0331 |
| **How fill col.** | 47.052 | 16 | 6.684e-05 |
| **Process fee** | 22.289 | 12 | 0.03441 |
| **Legal docs** | 18.217 | 16 | 0.3113 |
| **Cr. Avail** | 20.833 | 12 | 0.05289 |
| **Fil docs** | 21.655 | 12 | 0.04158 |

These findings are further supported by the results generated by the chi square test of independence between access to finance and information indicators. As shown in table 4.11, results indicate that there was a significant relationship between having knowledge on where to get credit and access to finance at P=0.05$\chi^2$ (27.833, 16). There was also a significant relationship between; having knowledge on how to fill financial documents and access to finance at P=0.001 $\chi^2$ (47.052, 16), having knowledge on processing fees and access to finance at P=0.05$\chi^2$ (22.289, 12), knowledge on credit availability being free and access to finance at P=0.01 $\chi^2$ (20.833, 12)as well as between having knowledge on filling financial documents and access to finance at P=0.05$\chi^2$ (21.655, 12).

## CONCLUSION

It is important from the findings that the factors affecting access to micro finance by micro enterprises is very significant to study and identify the opportunities and challenges in Garowe, Puntland. The study found out that the collateral requirement is very high, while accessing to credits. This is because of the banks are willing to reduce the risk of losing their loan. The study also reveals that an individual guarantor also plays to have access to credits in banks. Every lender should have to fill the requirement of the collateral before applying the loans from the banks.

Regarding, the cost of credit the study concludes there is a constraint access to microfinance by enterprises in Garowe, Puntland, and particularly banks' profit charge, which Banks charges high rates to the loans. There for, this resulted that the micro enterprises did not access to micro finances in the banks.

As, information and access to credit, the study found out that the respondents are known and have knowledge where to get and access to credit. The study also revealed that the more respondents were fully aware of the how to fill the collateral requirements, this encouraged that micro enterprises were able to know the process of the accessibility to micro finance by micro enterprises in Garowe, Puntland.

The study found out that business risk is one of the factors for access to credit, particularly, small businesses faces high competition. This revealed that banks didn't encourage for providing micro finances to micro enterprises. Since this might risk to collapse the business and couldn't repay their loans.

## RECOMMENDATIONS

Firstly, the study recommends that Microfinance institutions should simplify the collateral requirements for the accessibility to microfinance by micro enterprises. The study also recommends that micro enterprises establish proper accounting, financial system and valid licensing system, which micro finance can trust to pay their loans.

Secondly, the study recommends that Micro finance institutions and banks should reduce their bank's profit charge of which they charge to micro enterprises. The study also recommends strengthening the other processing system and minimizing the charge to the loans.

Thirdly, The study recommends that micro enterprises reduces the competitions among their counterparts, which are threat to their counter parts and maintain proper competition, which have positive impact to other micro enterprises. The study also recommends that Government, particularly the Ministry of commerce should issue a related policies including competitions, which guides the micro enterprises and supervises how they implement the policies as per required.

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