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ACCESS TO FINANCE AND FINANCIAL SYSTEM CHARACTERISTICS: A CASE OF SMEs IN NANDI COUNTY KENYA

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Abstract

This paper surveyed the relationship between access to financial services by SMEs and the financial system characteristics in Kenya. Although retail banking has improved markedly in Kenya in the last decade, access to credit for SMEs is still limited, with SMEs accounting for about 90% of all enterprises in the country, according to the Kenya Private Sector Development Strategy 2006-10. SMEs are provided with financial services by a range of institutions, including banks, non-bank financial institutions, savings and credit cooperatives (SACCOs), and microfinance institutions. The paper focused on two key areas: Access to financial services by the SME and its relationship to financial system characteristics. The target population was SMEs in the various industries operating in Nandi county-Kenya. The research design adopted was correlational survey. The data will be coded and analyzed using the SPSS. Factor analysis was carried out to ascertain the overlap of the data collected. The correlation and regression analysis was undertaken to ascertain the strength and direction of the relationship between the key variables. The results reveal that at one-sample t-test comparison of the financial system characteristics mean score indicates differences that were all statistically significant. The extent of its effect on access to credit varied from one SME to another (t-test = 42.684, p-value < 0.05). The study results show that at the financial system characteristics; size, capacity, policy, technology adoption and risk tolerance had positive and significant effect on access to finance. The key recommendations are based on financial institutions' internal policy, liquidity, product diversification and technology enhancement.

Keywords; Access, Financial system characteristics, SMEs, SACCOs, Kenya

INTRODUCTION

Small and Medium Enterprises (SMEs) have been known to contribute greatly in economic growth of both developed and developing countries. According to a report published in the journal of Economic Literature in the year 2010 about the manufacturing firms in developing countries, the share of SMEs in employment tends to be higher in developing countries, which are typically more focused on small-scale production. As such, policy provisions remain fundamental in propelling these enterprises towards self-sustenance and realization of their full potentials in contributing towards economic growth. (Evans, 2012)

In Kenya for instance, SME operation cut across almost all sectors of the economy and sustain majority of households. This was well recognized by the 2003, National Budget. It was noted that "SME activities form a breeding ground for businesses and Employees, and provide one of the most prolific sources of employment. Their operations are more labour intensive than the larger manufacturers." As such, policy provisions would mean boosting not only the operations of these enterprises but the country's economy as well. Allen (2007)

The Kenyan banking sector acknowledges, just as most banking sectors do globally, that there is an information asymmetry when it comes to understanding SMEs. Research has shown that banks have a tendency to treat small and medium enterprises (SMEs) as mini-corporate customers; as a result they don't best serve the needs of these businesses and in doing so lose opportunities to develop new customer relationships. When SMEs find themselves poorly serviced by the financial institutions (FIs), their growth can be restricted; and this in turn may have a negative impact on the national economy. One of the key reasons why banks are challenged in serving SMEs appropriately is that they lack an understanding of the evolving needs of fast growing SMEs Gale, (2007). In part this is due to the fact that SME growth stories are extremely diverse: for some, success means expanding the portfolio of businesses, for others it means growing the core activity of the business. In addition, SME success is not always directly measurable in a single company's financial statements and in such cases FIs need to look at the owner manager's complete portfolio of businesses and their accounts.

The journey towards SME policy formulation by the Kenyan government has been long. The government's commitment to foster the growth of Micro and Small Enterprises (MSEs) emerged as one of the key strategies in the 2006 report: Economic Management for Renewed Growth. It was reinforced as a priority in the 2006 report, The Strategy for Small Enterprise Development in Kenya: Towards the Year 2000. This report set out the mechanisms for removing constraints to growth of the MSE sector. In 2004, the government published the MSE policy report, Sessional Paper No. 2 Small Enterprises and Jua Kali Development in Kenya. The report was reviewed in 2012, leading to a new policy framework that provides a balanced focus

to SME development in line with the national goals of fostering growth, employment creation, income generation, poverty reduction and industrialization.

However, though these efforts are commendable, these are but perhaps baby steps compared to the task that lies ahead, namely unlocking the full potential of the SME sector to spur and sustain economic growth. For there to be long lasting changes, it is imperative for there to be concerted efforts starting at the policy level especially when it comes to issue identification and solution architecture. This is because, like in many developing countries, there have been considerable mountains of policy publications, data and research yet the problems still remain. Thakor, 2010

Statement of the problem

In the wake of the global financial crisis (GFC), many countries are prioritizing stability by strengthening financial regulation although important; this might be at the expense of inclusive growth, especially in poor countries. Without effective regulation, financial systems can become unstable, triggering crises that can devastate the real economy as evidenced by the recent GFC that began in 2007 (Spratt 2013). Given the primary purpose of finance is to facilitate productive economic activity; the aim of regulation is to maintain financial stability and to promote economic growth. This is a delicate balancing act, as too great a focus on stability could stifle growth, while a dash for growth is likely to sow the seeds of future crises. There are two different ways that regulation could impact on growth and stability (Spratt 2013). The first is by influencing the day-to-day behaviour of financial market actors so that financial regulation has direct effects, for example, on how much a bank chooses to lend to small and medium enterprises (SMEs). The second is by influencing how the financial system evolves structurally, thereby creating indirect effects. The diversity of the banking system, for example, will influence the pattern of lending by sectors.

Most of the developing country's economy is driven by SMEs which contribute 29 % in low income countries. This forms the backbone of a sustainable economic growth in the developing countries which cannot be over looked. The SMEs in Kenya have been given priority by the government policies and regulation through Comprehensive Financial Sector Reform and Development Strategy (Kenya Treasury, 2011). These SMEs do not realize their full potential due to the inability to access finance. These SMEs are largely characterized by lack of adequate operating capital, lack of appropriate technological skills and access to the global market. These factors contribute greatly to the access level of finance from the financial institutions. In Kenya, SMEs have continued to face challenges related to accessing finance due to lack of collateral which most financial institutions need before financing. Africa's SMEs 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 sectorial focus.

The formal financial sector consists of a large banking sector, a relatively well-developed securities market, a large number of insurance and retirement benefits schemes, microfinance banks (MFBs), and deposit taking savings and credit cooperatives (DTSs). The credit providers regulated by the Central Bank include 44 commercial banks (43 commercial banks and 1 mortgage finance company), and 12 licensed MFBs which target mostly informal microenterprises and lower income consumers. Commercial banks and microfinance banks are prudentially regulated by the Central Bank of Kenya under a set of statutes such as the Banking Act and the Microfinance Act as well as prudential guidelines and regulations issued by the Central Bank pursuant to this legislation. Deposit-taking savings and credit cooperatives, on the other hand, are regulated by the SACCO regulatory authority (SASRA). Mobile network operators have also become significant financial sector players through the provision of payments and have more recently acted as a channel for loans and savings products working in partnership with commercial banks. They are regulated by the CBK and the Communications Authority of Kenya (CA). The characteristics of the financial institution can be classified into size, operational policy, adoption of technology, capacity, risk tolerance level by the financial institution and product diversity. This study investigates the potential tradeoff between access to finance and financial system characteristics.

Objective of the study

To establish the influence of financial system characteristics on access to finance by SMEs in Kenya.

Hypothesis of the Study

H0: Financial system characteristics do not have a significant relationship with access to finance by SMEs in Kenya.

LITERATURE REVIEW

Small and Medium Enterprises (SMEs) have been known to contribute greatly in economic growth of both developed and developing countries. According to a report published in the journal of Economic Literature in the year 2000 about the manufacturing firms in developing countries, the share of SMEs in employment tends to be higher in developing countries, which

are typically more focused on small-scale production. As such, policy provisions remain fundamental in propelling these enterprises towards self-sustenance and realization of their full potentials in contributing towards economic growth.

In Kenya for instance, SME operation cut across almost all sectors of the economy and sustain majority of households. This was well recognized by the 2003, National Budget, which noted that “SME activities form a breeding ground for businesses and Employees, and provide one of the most prolific sources of employment. Their operations are more labour intensive than the larger manufacturers.” As such, policy provisions would mean boosting not only the operations of these enterprises but the country’s economy as well.

The vast majority of firms around the world fall into the category of micro, small- or medium-sized enterprises (SMEs). In terms of enterprises, more than 95 percent fall into this category, but even in terms of employment in low- and lower-middle-income countries, more than 50 percent of employees work in companies with fewer than 100 employees (Ayyagari, Demirguc-Kunt and Maksimovic, 2011). While SMEs thus constitute an important component of the private sector in the developing world, they report significantly higher obstacles to their operation and growth than large enterprises (Beck et al., 2006). Among these obstacles, the lack of access to appropriate financial services, especially lending services, looms large.

Africa’s financial systems are small, shallow and costly, with limited outreach. This is not just reflected in ag¬gregate financial development indicators but also in firm and household data gauging the use of formal financial services (Beck and Cull, 2014). However, financial systems in Africa have also seen dramatic changes over the past two decades in market structure and stability. And there are enormous differences across the region, ranging from well-developed financial systems in middle-income middle-income countries, such as Mauritius and South Africa, to shallow banking systems offering only the most rudimentary financial services in impoverished countries like the Central African Republic and South Sudan

While a great amount of literature has established the positive impact of financial deepening on economic growth and poverty alleviation, especially and foremost in developing countries (Levine, 2005), recent evidence using firm-level data has pointed to SME finance as an important channel. The literature has identified different channels through which financial development affects firm and, ultimately, aggregate growth. First, the availability of external finance is positively associated with the number of start-ups—an important indicator of entrepreneurship—as well as with firm dynamism and innovation. Second, finance allows existing firms to exploit growth and investment opportunities and to achieve larger equilibrium size. Finally, firms can safely acquire a more efficient productive asset portfolio where the

infrastructure of finance is in place, and they are also able to choose more efficient organizational forms such as incorporation. (Beck 2014)

Access to formal finance is poor because of the high risk of default among SMEs and due to inadequate financial facilities. Small business in Africa can rarely meet the conditions set by financial institutions, which see SMEs as a risk because of poor guarantees and lack of information about their ability to repay loans. 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 SMEs. Non-bank financial intermediaries, such as micro-credit institutions, could be a big help in lending money to the smallest SMEs but they do not have the resources to follow up their customers when they expand. Reasons why SMEs find it hard to access finance are: • High interest rates – disparities between savings account returns and borrowing rates • Collateral requirement – Land ownership etc • Multiple transaction costs • Delays in processing • Inflexible conditions • Government requiring unmovable collateral • SME's to have good track records • SACCO's demanding group borrowing rather than individual companies • Lack of transparency – Conditions and requirements are not shown in advance • Slow in processing loans• Lack of skills to present bankable projects • High default rate

Kenya has had a long history of economic leadership in East Africa's one of its largest and most advanced economies. However, inconsistent efforts during the structural reforms era coupled with poor economic policies and state complicit corruption syndicates over the past decades have hemorrhaged development and growth significantly eroding the leadership at a time when other countries in the region have made significant strides (Lee, 2004)

The dichotomous policy perception of formal and informal business entities has also contributed to ineffective policies on the SME economy as merely-jua kali. It was not until the beginning of 2003 that there was deliberate Government debate on the need to integrate the two sectors. At the time, analysis of the SME sector revealed that development and integration of both the informal and formal sectors has to a large extend been constrained by regulatory requirements. Most of these requirements date back to the colonial period and have no relevance in independent Kenya.

There is not doubt that Small and medium-sized firms are the drivers of the Kenyan economy. They employ about 7.5 million Kenyans or 80 per cent of the country's total employment outside the small-scale agriculture. But little has been understood about their operations, ownership, source of capital and the key challenges that they face as they propel growth of the Kenyan economy. This could be the reason why they should be supported to graduate from their current state. Perhaps we should ask: are there certain efforts in progress?

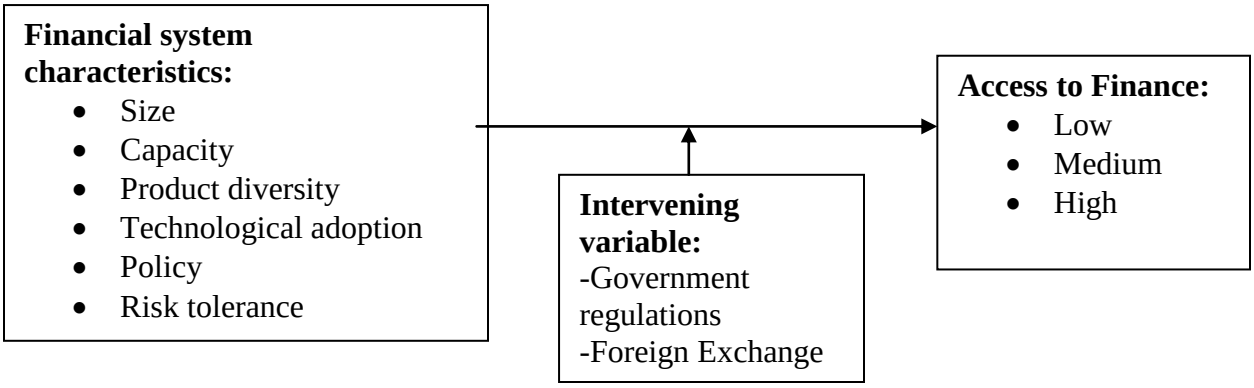
For one, lack of insight on the sector has left policy makers, key support players such as financial institutions and others groping in the dark on how best to implement SME policies. However, all is not gone, there is still light at the end of the 'SME policy tunnel.' (Fazzari, 2008)

The Government as the sole regulator and licensor plays a crucial role in SME development through different ministries, departments and state corporations. Key organs of government such as cabinet office, Parliament and Local Authorities concerned with policymaking have to grasp the role of government in SME advancement, and be aware of the impact new policies and laws impose on the operations of small enterprises. In doing this, the government establishes the institutional framework for business – rules of the game and ensures that promising enterprises receive appropriate incentives to facilitate efficient performance. Such interventions have potential for mainstreaming the informal economy alongside larger formal enterprises.

The study is also based on the assumption that financial system characteristics affect access to finance by SMEs in Kenya. It is on this view that the study formulated the following null hypothesis:

H0 Financial system characteristics do not affect access to finance by SMEs in Nandi County

Figure 1. Conceptual Framework



METHODOLOGY

A research design refers to the overall strategy that you choose to integrate the different components of the study in a coherent and logical way, thereby, ensuring you will effectively address the research problem; it constitutes the blueprint for the collection, measurement, and analysis of data (Sakaran, 2003).This study was a survey research design as the research involved collecting data as reported by individuals. The data was then described and further correlated to create a snap shot of the current state of affairs and to establish and describe the relationships among two or more study variables. Descriptive research design allows the

researcher to evaluate and describe the relationship between the study variables which are associated with the problem. Correlational design also allows a researcher to measure the research variables by asking questions to the respondents and then examining their relationship (O'Connor, 2011). Therefore the study was descriptive correlational study. Descriptive was chosen because it provides a relatively complete picture of what is occurring at a given time and allowed the development of questions for further study while correlational research design allowed testing of expected relationships between and among variables, making predictions and can assess these relationships in everyday life events.

Study Area

The study was carried out in Nandi County where SMEs support directly indirectly over two million people in Nandi County (KSB, 2012). The challenges faced by SMEs range from regulations, aces to finance, access to markets for their products and know-how of running the business. These issues push the business to seek alternative sources of financing hence the need to carry out the study in this area. The proximity to the researcher is another reason as to why this area was chosen; this allowed the researcher to conduct the research adequately and within the stipulated time period.

Population

The target population for this study comprised of all SMEs owners in Nandi county. They were preferred because they are likely to exhibit elaborate relationships between the study variables since they are highly knowledgeable on issues related to financing their businesses

The population of the study was 6,200. *KNBS (2012)*

Sampling design

The study will focus on SMEs owners in Nandi County. The researcher used multi stage sampling techniques to get the sample size. The first stage sampling included selection of the industries, the second stage included use of random sampling to pick the SMEs owners from the identified industries. The sampling technique was as follows:

A 95% confidence level and P = .5 are assumed for the Equation. Where n is the sample size, N is the population size, and e is the level of precision.

The formula is-

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

.

Sample size= $\frac{6,200}{1+6,200\ (0.05)^2}$

With a total population of 6,200 SMEs in Nandi County, the sample size is thus: 399 SMEs owners.

Data collection instrument

According to Mugenda, (2003) data collection instruments are the tools that assist the researcher in the process of gathering and measuring information on variables of interest, in an established systematic fashion that enables one to answer stated research questions, test hypotheses, and evaluate outcomes. For this study, the researcher will use questionnaires. The questionnaires have both open-ended and closed-ended, and were divided into three parts. Part I contains general information of the respondent, part II contains questions on access to credit and lastly part III contains questions on financial system characteristics.

Pilot Study

In order to ensure content validity of the research instrument, the preliminary questionnaire was pre-tested on a pilot set of respondent for comprehension, logic and relevance. Respondents in the pre-test were drawn from a section of SMEs owners in the County. They will be similar to those in the actual study in terms of background characteristics. The respondent on which the pre-testing was done was not part of the target population of study. 30 SMEs owners randomly selected were used in the pilot study.

Validity of research instrument

All the aspects of the questionnaire were pre-tested including question content, wording, sequence, question difficulty, layout and form and instructions. The feedback obtained was used to revise the questionnaire before administering it to the study respondents. Both the questionnaire and the measurement process was guided by the conceptual framework in order to measure the key elements of access to finance and financial system characteristics and ensure construct validity because they reflect the key components of the study variables.

Reliability of Research Instrument

Reliability on the other hand refers to the measure of the degree to which a research instrument yields consistent results on across time and across the various items of the instrument (Sekaran, 2003). Reliability is the extent to which an instrument is predictable, stable, accurate and dependable to yield the same results every time it is administered. Cronbach's alpha

coefficient was used to measure the reliability of the scale, which was also used to assess the interval consistency among the research instrument items. This is because it is strong in determining the inter consistency or average correlation of items in a survey instrument to gauge its reliability (Santos, 2009).

Data analysis and presentation

The positivistic approach to research guided data analysis was used for the study. Positivism advocates for hypothesis testing using quantitative techniques (Stiles, 2003). The data followed Sekaran, (2003) four step process of data analysis; getting data ready for analysis which involves getting a feel of the data, testing the goodness of the data and testing the hypothesis. The data was subjected into factor analysis in order to determine the suitability of the data for regression analysis. According to Kothari (2010), factor analysis is a useful tool for investigating variable relationships for complex concepts such as socioeconomic status, dietary patterns, or psychological scales. It allows researchers to investigate concepts that are not easily measured directly by collapsing a large number of variables into a few interpretable underlying factors. Descriptive statistics was used to obtain a general understanding of the respondents' characteristics. Both parametric and non-parametric tests were done depending on measurement scale. In an effort to establish the suitability of the data for regression analysis by ensuring that the dependent and independent variables have a statistically significant relationship while at the same time controlling for multicollinearity problem which occurs if any two independent variables are highly correlated (Cooper & Schindler, 2005), correlation analysis was used to measure the strength of the relationship between access to finance and financial system characteristics. The relationship between access to finance and financial system characteristics was expected to follow the multiple linear regression models as follows:

$Y = \beta_0 + \beta_1 X_1 + \varepsilon$

Where:

Y = Dependent variable (access to finance).

β_0 = Constant or intercept which is the value of dependent variable when all the independent variables are zero.

β_1 = Regression coefficient for each independent variable.

ε = The slandered error term random- variation due to other unmeasured factors.

X_1 = Financial system characteristics; Size, Capacity, Product diversity, Technological adoption, Policy, Risk tolerance

Response level, Data coding and Cleaning

Although the study had intended to collect data from a sample of 399 SMEs owners, the researcher managed to successfully collect data from 282 of them. This represents a response rate of 71 percent of the target population and the researcher considered the response rate good enough. The data was then coded and cleaned through extensive checks for consistency. Data was analyzed using a set of descriptive and inferential statistics in statistical package for social sciences (SPSS) version 12.0 software.

FINDINGS

Descriptive Study Results

The financial system characteristics were assessed by six measures: Size, Capacity, Product diversity, Technological adoption, Policy, Risk tolerance. This was measured on a scale of 1 to 5 (where 5= the greatest extent and 1 is the lowest extent). Most of the financial characteristics are to a great extent correlated to access to credit facilities. With size (Mean 4.150), product diversity (mean 4.21) and technological adoption (mean 4.24). However, capacity (mean 3.29) and policy (3.40) were moderate. Overall, the intensity of financial system characteristics was considerably high (mean 3.808).

The results reveal that at one-sample t-test comparison of the financial system characteristics mean score indicates differences that were all statistically significant. The extent of its effect on access to credit varied from one SME to another (t-test = 42.684, p-value < 0.05)

Table 1. Financial System Characteristics

Financial system characteristics	N	Mean	Std Deviation	t-value	Significance (P-Value)
Size	282	3.850	.866	36.724	0.000
Capacity	282	4.100	.830	27.374	0.000
Product Diversity	282	3.700	.842	42.684	0.000
Technological Adoption	282	3.750	.766	39.814	0.000
Policy	282	4.150	.726	26..321	0.000
Risk Tolerance	282	3.400	.860	26.292	0.000

Factor analysis for Financial system characteristics

From the results, KMO has an index of 0.56. From the study results, the Bartlett's Test of Sphericity has p-value of 0.000 which is less than the stated $\alpha = 0.05$, implying that the test is highly significant; hence the factor analysis is appropriate.

Table 2. Results of Factor Analysis for Financial System Characteristics

	Component	
	Financial institutions policy	**Financial institutions capacity**
The size of the bank influences my access to finance		.774
The diversity of the banks products affects my access to finance		.652
The capacity of the banks employees has an influence on my access to finance		.614
Bank's risk tolerance affects my access to finance	.915	
Level of Technology adoption by a financial institution affects my access to finance	**.**896	
Financial institution policy affects by business access to finance	.924	
Overall Mean	**3.883**	**3.733**
Cronbach's Alpha	**0.938**	**0.789**

Extraction Method: Principal Component Analysis.

a. 2 components extracted.

From the study results, financial system characteristics: financial institutions policy and financial institutions capacity relate to access to finance profitability accounts for 50.771% and 46.146% respectively of the total variance. Cumulatively, 76.917% of the variance is accounted for by the two factors. From the study results, the system has identified the two as important factors to be loaded in the analysis.

The measures of financial system analysis were subjected into the reliability test using Cronbach's alpha coefficient and were found to have Cronbach's alpha coefficient of 0.738 hence considered to be reliable in that they all had alpha coefficient greater than the minimum accepted Cronbach's alpha coefficient of 0.70.

Table 3. Overall significance ANOVA (F-test)

Model		**Sum of Squares**	**Degree of Freedom**	**Mean Square**	**F**	**Sign. (P-value)**
Financial institutions policy	Regression	1.362	4	1.362	1.621	0.008
	Residual	5.351	316	0.334		
	Total	6.713	320			
Financial institution capacity	Regression	1.081	5	1.018	2.162	0.024
	Residual	2.230	315	0.216		
	Total	3.311	320			

The ANOVA results shows that on overall significance, there is a statistically significant relationship between access to finance and financial system characteristics because the p-value is less than the set value of 0.05 (p – value = 0.008).

Correlation between access to finance and financial system characteristics

The relationship between access to finance which was the dependent variable of the study and financial system characteristics was assessed using Pearson product moment correlation. As shown in Table 4 below, there is a positive correlation between access to finance and financial system characteristics ($r = .638$, $p<0.05$).

Table 4. Correlation between access to finance and financial system characteristics

	Scale	1	2	3
1	Financial System Characteristics	1		
2	Access to finance	.438*	1	

*Correlation is significant at the 0.05 level (2-tailed).

Regression Analysis for access to finance and financial system characteristics

To assess the level of significance of the relationship between access to finance and financial system characteristics among SMEs in Kenya, the study formulated the following null hypothesis;

$H_{0:}$ Financial system characteristics do not have a significant relationship with access to finance by SMEs in Kenya.

The null hypothesis (H_0) tested the direct relationship between access to finance and financial system characteristics among SMEs in Kenya using aggregate mean scores. The measures of financial system characteristics mean scores were regressed against those of access to finance measures and the relevant research findings are presented in Table 5.

Table 5. Regression Results of Access to finance against Financial System Characteristics

Goodness Fit Analysis: Model Summary(b)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.204(a)	.163	.046	.83466

a Predictors: (Constant), Financial system characteristics

b Dependent Variable: Access to finance

Overall significance, ANOVA(b)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.543	1	.543	.779	.012(a)
	Residual	2.787	316	.697		
	Total	3.329	320			

a Predictors: (Constant), Financial system characteristics

b Dependent Variable: Access to finance

Individual significance (T-test): Coefficients(a)

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	4.016	5.120		1.565	.193
	Financial System Characteristics	1.184	1.342	.204	.883	.042
	Access to Finance	0.365	0.779	0.266	2.289	0.028

a Dependent Variable: Access to finance Lever of significance, α = 0.05

From the Table 5, the regression results reveal that access to finance had overall significant positive relationship with the financial system characteristics among SMEs in Kenya (β = 0.204, p-value = 0.012). The hypothesis criteria was that the null hypothesis H_0 should be rejected if β ≠ 0 and p-value ≤ α otherwise fail to reject H_{04} if the p-value > α. From the above regression results, β ≠ 0 and p-value < 0.05, hence the study therefore rejects the null hypothesis since β ≠ 0 and p-value ≤ α and concludes that access to finance by SMEs is affected by financial system characteristics.

The study results show that at the individual level, all the indicators of financial system characteristics had a positive influence on access to finance as follows: Financial institution: size (β = 0.204 and p-value = 0.042), Capacity(β = 0.314 and p-value = 0.002), Product diversity(β = 0.194 and p-value = 0.054), Technological adoption(β = 0.214 and p-value = 0.062), Policy, (β = 0.304 and p-value = 0.032), Risk tolerance(β = 0.224 and p-value = 0.012)

Arising from the research results in Table 5 the resulting regression model that predicts the level of access to finance (AF) for a given characteristics of financial institutions (FI) stated as follows: AF = 2.681+ 0.204FI

Where: 2.681 = y-intercept constant, AF = Access to Finance, 0.204= an estimate of the expected variance in financial system characteristics corresponding to an increase in access to finance for a change in financial system characteristic

CONCLUSION

The study found out that financial system characteristics had overall significant positive relationship with access to finance by SMEs in Kenya (β = 0.204, p-value = 0.012). The study results show that at the individual level, all the indicators of financial system characteristics size, capacity, policy, technology adoption and risk tolerance had positive and significant effect on access to finance.

Financial system characteristics had overall significant positive relationship with access to finance by SMEs in Kenya hence the study concludes that SMEs need to consider the various characteristics depicted by the financial institutions since this determines their ease or difficulty in accessing finance

RECOMMENDATIONS

Policy

Financial institutions' internal policy

The loan policy is the primary means by which senior management and the board guide lending activities. Lending policies should be clearly defined and set forth in such a manner as to provide effective and efficient access by the SMEs. The board of directors of every financial institution has the legal responsibility to formulate lending policies and to supervise their implementation. Therefore the financial institutions should encourage establishment and maintenance of written, up-to-date lending policies which aid in reaching out to the needs of the SMEs. A lending policy should not be a static document, but must be reviewed periodically and revised in light of changing circumstances surrounding the borrowing needs of the financial institutions' customers as well as changes that may occur within the bank itself. To a large extent, the access to credit by the SMEs served by the financial institutions dictates the composition of the loan portfolio.

Policies should be periodically reviewed and revised to accommodate changes in the financial institutions' strategic direction, risk tolerance, or market conditions. Policy review should consider the organizational structure, breadth and complexity of lending activities, capabilities and skills of lending personnel, and strategic portfolio quality and earnings objectives.

Liquidity

Liquidity has multiple dimensions in the context of banks, being relevant on both the liability side and the asset side of bank balance sheets. On the liability side, funding liquidity is the primary concern. Liquidity also impacts bank portfolio composition in terms of small business loans

relative to total assets and total loans, as well as the mix of small versus large loans. Financial institutions should typically react to changes in their own liquidity buffers and to their exposure to provide liquidity on demand to their customers, and, in particular, how the bank responses might differ from their normal responses during a liquidity crisis.

Product diversification

Small and medium enterprises (SMEs) are critical for the economic and social development of emerging markets. They play a major role in creating jobs and generating income for low income people; they foster economic growth, social stability, and contribute to the development of a dynamic private sector. As such, access to financial services is vital in developing a vibrant SME sector in any economy. In many emerging markets, however, access to financial services for SMEs remains severely constrained. Financial institutions need a formal, fully developed process for developing and managing new products. Banks should consider a strategy that focuses on an innovation layer to make the issue of constantly shifting regulation moot. Banks need a system that can transform a product-centric environment into a customer-centric one. Banks need solutions that allow them to add value to their customer relationships through new product innovation.

Technology enhancement

With technology changing constantly, it's important that banks not just track but also adapt to what's trending around the world. Most bankers recognize the swift and ever-increasing pace of technology change that is influencing and impacting their business. Financial institutions that act fast to manage the disruption will need to evolve their corporate culture to empower people customers, workers and ecosystem partners to accomplish more with technology and usher in the new business strategies that those technologies drive.

A powerful combination of new regulation, evolving customer needs and the emergence of new players and technologies is driving an unbundling of SME banking. This has created a clear but short-lived window of opportunity for financial institutions to seize the initiative and grow SME market share and revenues. However, getting SME banking right presents challenges and risks in a period of intense economic uncertainty. Whether SMEs are less reliant on credit, or are merely tapping alternative funding sources, the traditionally strong credit relationship between financial institutions and business customer is eroding.

To harness the SME opportunity, financial institutions must be innovative across the supply chain, within origination, fulfillment as well as service and portfolio management by

implementing new value-based and needs-based segmentation models, offering SMEs variable pricing and service options across products, and access and support through multiple channels.

LIMITATIONS AND FURTHER STUDIES

The study was subject to some limitations which provide avenues for further research despite the fact that it produced meaningful results. The study had its first limitation of getting the best combination of various classifications of financial characteristics in order to relate it with access to finance. The study also did not pave way to look at how financial characteristics shape access to finance and instead took a one directional perspective. A further research can be undertaken to identify this.

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