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**AN ANALYSIS OF THE EFFECT OF CROWDFUNDING PLATFORMS IN
ENHANCING THE FINANCING SOURCES FOR MICRO, SMALL AND MEDIUM
ENTERPRISES (MSMEs) IN KENYA**

BY

LINDA ONYANGO

**A Dissertation Submitted In Partial Fulfilment for the Award of Degree in Master of Business
Administration**

**Strathmore Business School
Strathmore University**



APRIL, 2018

DECLARATION

This dissertation is my original work and has not been presented for an award of a degree in any other University.

Signed..... Date

Name:

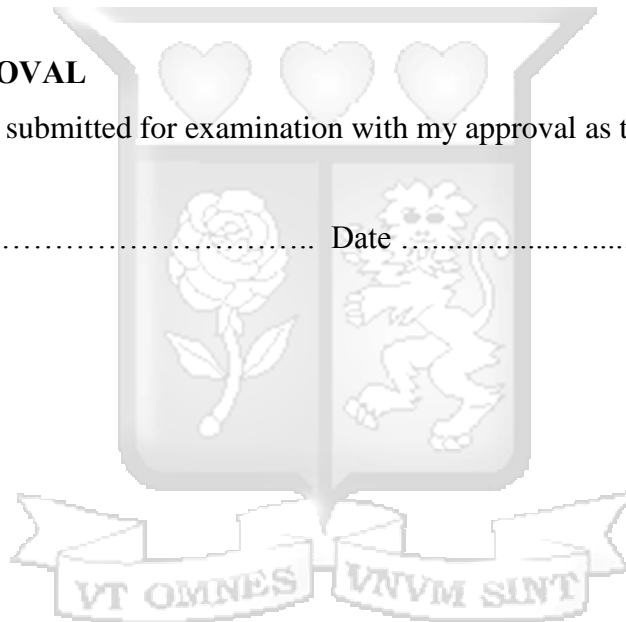
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SUPERVISOR'S APPROVAL

This dissertation has been submitted for examination with my approval as the University Supervisor:

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Supervisor:



ABSTRACT

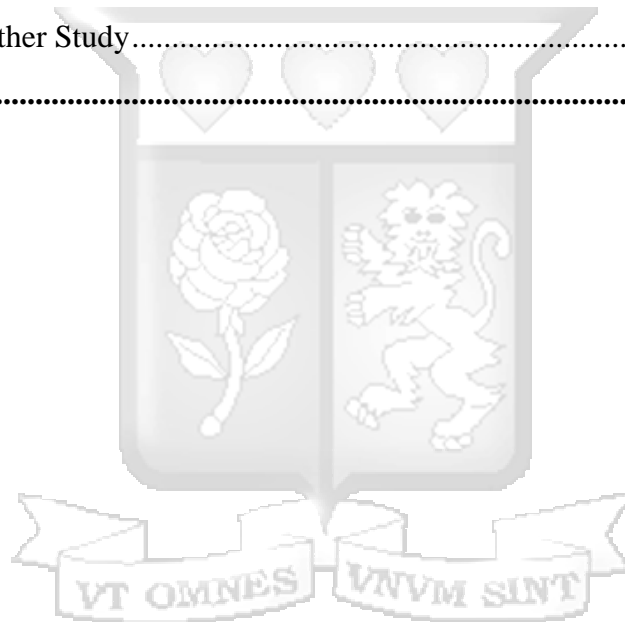
The Micro, Small and Medium Enterprise (MSME) sector plays a significant role in the Kenyan economy, offering opportunities for employment and innovation. However, there exist a financing gap due to limited personal finances, credit, grants, equity and other sources of finance that subsequently limits MSMEs access to funding. This further inhibits many entrepreneurs from sustaining and growing their enterprises. The crowdfunding platform phenomenon was first adopted in the developed world and has grown exponentially over the years with many entrepreneurs employing crowdfunding platforms to raise capital for the enterprises' financial needs. Unfortunately, African countries lag behind in the adoption of crowdfunding with very few locally established crowdfunding platforms and a general lack of awareness of the use of crowdfunding platforms as source of finance for entrepreneurs'. The purpose of this study was to analyse the financing gap that exists in MSMEs in Kenya and the role that crowdfunding platforms play in enhancing their financing opportunities. This study was exploratory and it used both primary and secondary data in answering the research questions. Primary data was collected by targeting a population of 30 MSMEs that have accessed financing from the 48 crowdfunding platforms accessible to Kenyan. The study was able to achieve a response rate of 96.7%. Secondary data was collected from the World Bank and Central Bank of Kenya and used to analyse the average MSME financing gap at a national level. From the primary data, the average success rates of four different types of crowdfunding platforms was determined as percentage of amounts raised from the platform versus the target amounts the entrepreneurs' were seeking from these platforms. The average success rate for each platform was then applied to national average financing gap to provide a recommendation on which platform could be an ideal contributor in narrowing the financing gap for MSMEs in Kenya.

The study findings reveal that the mean success rate is highest for lending platforms (100%) followed by reward platforms (87%, donation platforms (46%) and finally equity platform (0%). From the secondary data the average financing gap is USD 7,545 per registered but underserved MSMEs. The extent to which the various challenges faced by MSMEs in accessing funding such as value and size of MSME network, human effort required, compatible payment systems, due diligence process required was analysed and discussed depending on the platform type. The highest contribution to the national average financing gap evidently came from the lending platforms and was the recommended platform as long as an entrepreneur is able to pass the due diligence required in order to access funds from these platforms. In the arena of academia, scholars can contribute towards this end by undertaking more studies to fill the knowledge gap particularly on the size of financing gap facing MSMEs in Kenya especially from a demand side.

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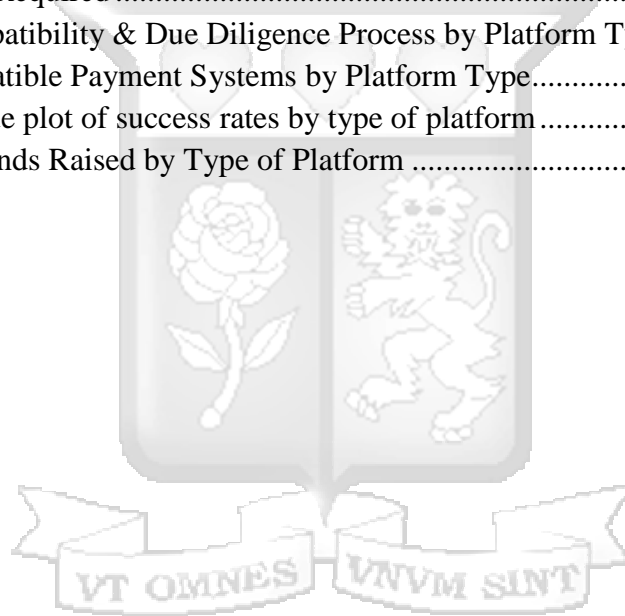
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LIST OF ABBREVIATION AND ACRONYMS

FSD	Financial Sector Deepening
GDP	Gross Domestic Product
OECD	Organisation for Economic Co-operation and Development
SACCO	Savings and Credit Co-operative
MSMEs	Micro, Small and Medium Enterprises



DEFINITION OF KEY TERMS

Financing Gap	A gap that exists due to limited personal finances, credit, grants, equity and other sources of finance that subsequently limits MSMEs access to funding.
Success Rates	The success rate of a crowdfunding platform campaign is defined by the achievement of the campaign target set by the entrepreneur. The campaign target is assumed to be the “funding gap” for the MSMEs that chose to use crowdfunding platforms to enhance the financing sources for their business



CHAPTER ONE

INTRODUCTION

1.1. Introduction to the Study

MSMEs have attracted a lot of scholarly interest all over the world because of their dynamic economic importance (Beck, Demirgüç-Kunt, & Levine, 2003; Kamweru, 2011; Kongolo, 2010; Wanjohi, 2010). Underlying the numerous definitions offered to describe MSMEs, are four main criteria for MSMEs classification. They are total net assets, sales, investment level and the most commonly used, number of employees (Ayyagari, Beck & Demirgüç-Kunt, 2003). In Kenya the definition for Micro, Small and Medium Enterprises (MSMEs) is derived from the Kenyan MSME Act No.55 2012 and primary data from two banks namely Chase Bank and Kenya Commercial Bank(KCB) that used the criterion of number of employees and business turn over (Kushnir, 2010). For purposes of this study, the definition of MSMEs in Kenya will be those with a maximum number of 99 employees and annual turnover of Ksh 800 million.

Table 1.1 Definition of MSMEs

ENTITY(Trade, service, industry or business activity)	NO. OF EMPLOYEES/PEOPLE	ANNUAL TURNOVER	INVESTMENT IN PLANT AND MACHINERY+ REGISTERED CAPITAL	EQUIPMENT INVESTMENT PLUS REGISTERED CAPITAL
Micro enterprise	Less than 10 people	Not exceeding Ksh 500,000	Not exceeding Ksh 10M	Not exceeding Ksh. 5M
Small enterprise	More than 10 but less than 50	Between Ksh 500,000 to Ksh 5 million	More than 10M but less than 50M	More than 5M but less than 20M
Medium	50-99	Ksh 5 million to Ksh 800 million	Not specified	Not specified

Adapted from MSME Act, 2012, Chase Bank 2017, KCB 2017

According to World Bank's (2013) report *Crowdfunding Potential for Developing World*, crowdfunding platforms have been defined as an Internet-enabled way for MSMEs or other organizations to raise money typically from about US\$1,000 to US\$1 million in the form of either donations or investments from multiple individuals. This new form of capital formation emerged in the wake of the 2008 financial crisis in response to the difficulties faced by early-stage enterprises in generating funding. In less than a decade, crowdfunding through these platforms has spread across the developed world, and is now attracting considerable interest from the developing world as well.

Crowdfunding platforms begun as an online extension of financing by friends and family where communities pool money to fund members with business ideas. They afford Micro Small and Medium Enterprises (MSMEs) with access to capital, nurturing high-growth entrepreneurs in the developing world, advocating access to export markets and facilitating flows of capital within and between communities, regardless of distance (World Bank, 2013). During its early stages, capital came in the form of donations, but it is increasingly taking the form of debt or equity investments targeting high-growth entrepreneurs.

1.2. Background to the Study

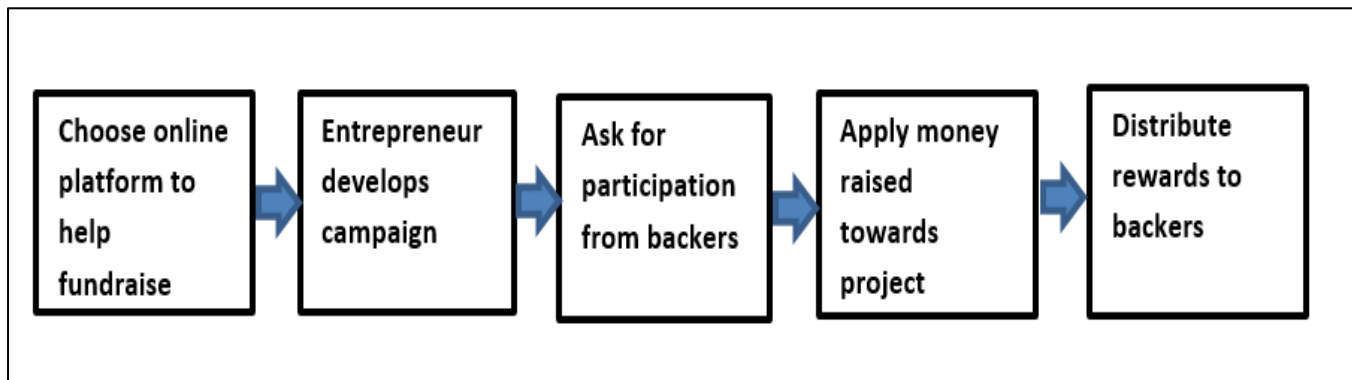
The idea of crowdfunding platforms was inspired by microfinance (Morduch, 1999) and crowdsourcing (Poetz and Schreier 2012). It however has distinctive fundraising characteristics that encompass its vehicles, processes, and objectives. The World Bank (2013) categorises crowdfunding through these platforms into Crowdfund Investing (CFI) and Donation Crowdfunding. CFI started in Australia before its adoption in the United Kingdom and is now circulating across the globe with North America having the highest funding volumes (Massolution, 2015). It denotes bringing in capital by trading financial instruments associated with the firm's assets and/or the financial performance. CFI has been further categorized into equity-based crowdfunding and lending-based crowdfunding. It has in recent times materialized as a substitute to more customary funding instruments like informal loans from friends and family, loans from banks and investments from angels or venture capitals (VC) for funding MSMEs. According to a Massolution (2015) report, *2015CF Crowdfunding Industry Report*, lending-based crowdfunding surpassed Angel Investing in 2015 and was on trend to surpass Venture Capital in 2016.

On the other hand, Donation Crowdfunding raises non-equity capital for creative projects or charity causes instead of the sale of securities. In a number of instances, donations could back an early stage company or product innovation, in order to acquire a product or service early. Donation crowdfunding can also take the form of a reward, where funders receive a token of appreciation and it is occasionally complementary to social lending (peer-to-peer) platforms. In 2015, donation crowdfunding volume increased by \$5.5 Billion (Massolution, 2015).

Crowdfunding platforms use two mechanisms; all-or-nothing mechanism or keep-what-you-earn mechanism. In the former, for instance www.kickstart.com, all the money is collected only if the funding goal is reached in a specified time period (Vien, 2015). In the latter, as in www.Indiegogo.com,

the funding is collected whether or not the goal was attained in the dedicated time span (Figliomeni, 2015). **Figure 1.1** shows the lifecycle of a typical crowdfunding campaign.

Figure 1.1 Crowdfunding workflow



Adapted from Meyskens & Bird, 2015

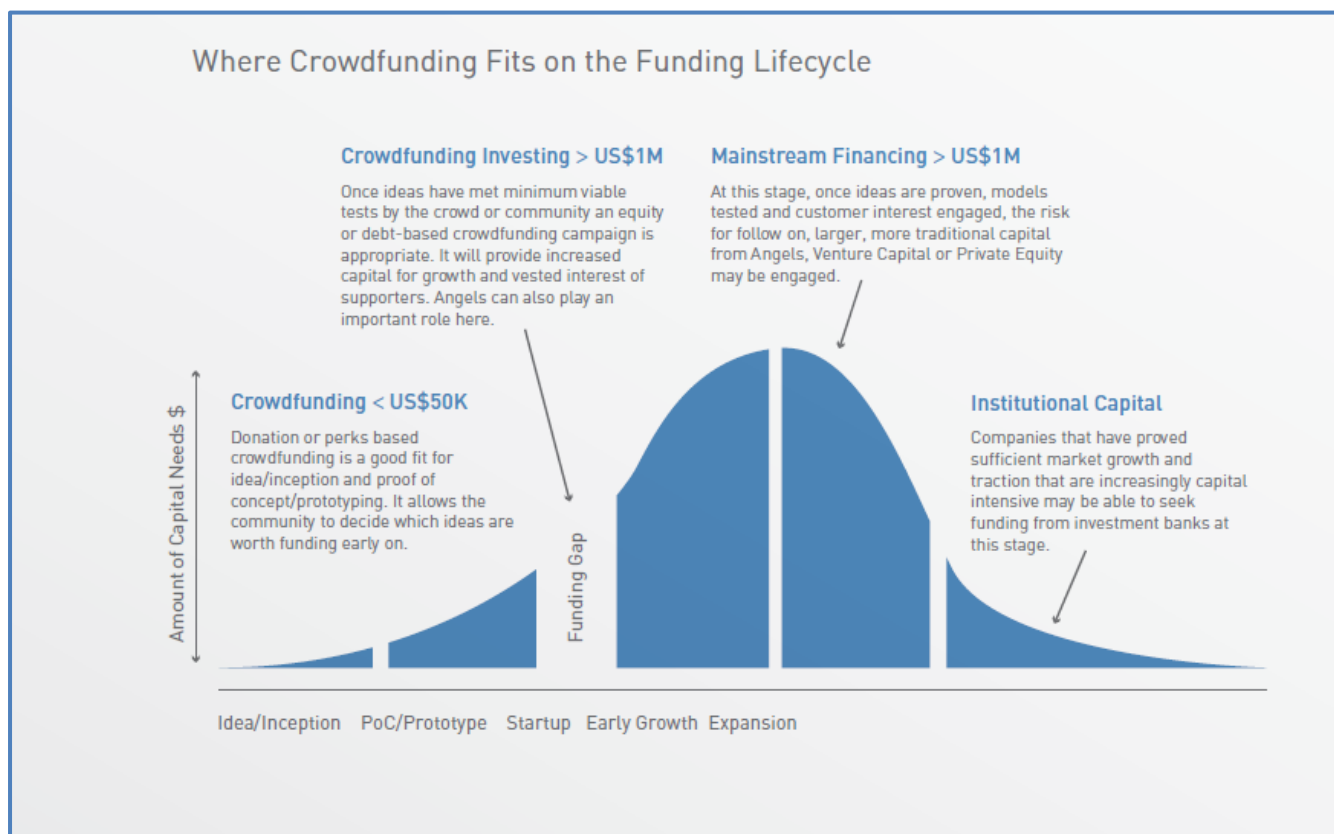
The two major forces that enable crowdfunding platforms are the prevalent absorption of Information and Communication Technology (ICT) and the overall positive reception of digital social networks. While ICT has provided a communication infrastructure for a multitude of investors, digital social networks assist in facilitating online collaboration and building confidence in people with whom these investors would traditionally have limited connections with. These forces combined, by connecting potential investors with potential investments, have expedited the emergence of crowdfunding platforms on a large scale since its initiation just six years ago (World Bank, 2013).

Relationship between Crowdfunding Platforms and Finance in MSMEs

Crowdfunding platforms can be utilized by several MSMEs to generate capital. Regardless of robust returns and solid fundamentals, conventional MSMEs may lack access to bank loans or other financing. Approximately 70 percent of all MSMEs in emerging markets do not have access to credit (World Bank, 2015). Crowdfunding therefore provides them with the option to translate customers into investors or lenders, bringing in the capital that facilitates growth (World Bank, 2013). **Figure 1.2** illustrates the manner in which crowdfunding corresponds to the funding lifecycle of budding MSMEs.

Crowdfunding platforms might however not be appropriate for businesses with long payback revenue models and high cost structures, or those that need huge upfront capital overheads like large-scale infrastructure projects. Restraints on the cash amount that can be raised using crowdfunding platforms or a payback time horizon that is not near enough in the future to attract crowdfunding platform investors, could limit such companies.

Figure 1.2 Crowdfunding Adoption Curve



Adapted from World Bank 2013, p 16

Effect of Crowdfunding Platforms on MSMEs

Originally founded upon lobbying for pledges or donations, crowdfunding platforms have grown into a multibillion-dollar international industry; raising money for individuals or organizations for product development, as seed finance and social causes (World Bank, 2013). There are more than 1250 crowdfunding platforms today and this number will definitely grow with regions like South America and Africa still picking up on the crowdfunding platform trend (Drake, 2016).

By 2015, the global total standing of money raised through crowdfunding platforms was at US\$34.4 billion, about 200% volume increase from the previous year. It is projected that, over the coming years, the scope of the crowdfund investing market will vary between US\$3.98 billion (Best, Neiss, Stralser, and Fleming 2013) and US\$300 billion contingent on the degree of enabling regulation that governments implement (Huessner, 2012). Geographically, North America continues to dominate the crowdfunding platforms industry, with China surpassing Europe in 2015, to become second in funding volume. Africa still lags behind in funding volumes since use of crowdfunding platforms is still at a nascent stage (World Bank, 2015).

Crowdfund investing has been a good fit for various MSMEs. Many of them have benefited in raising capital to meet their financial needs (purchase of equipment, working capital, start-up capital). This capital has helped the MSMEs to move closer to self-sufficiency and investment readiness (Macht and Weatherston, 2014). High growth/technology MSMEs are exceptionally well-matched to crowdfund investing more so those that bring into play entrepreneurial incubator or accelerator ecosystems. They find general market understanding and acceptance, and can leverage the expertise, facilities, mentoring, and peer learning capabilities those ecosystems offer. They also gain access to wide-ranging markets for fundraising and sales (World Bank, 2013).

1.3. Problem Statement

Micro, Small and Medium Enterprises (MSMEs) are important contributors to the economic development of any country. They play a significant role in employment creation, especially in Africa, providing 60 percent of the overall formal employment in the global manufacturing industry (Ayyagari et al, 2007). Up to 45 percent of overall employment in emerging markets comes from formal SMEs including at most 33 percent of national income (GDP), (World Bank, 2015).

Following this, the government of Kenya has run a number of initiatives to facilitate the expansion of the MSME sector. For instance the Uwezo Fund, the SME Competitiveness Project and the Private Sector Development Strategy (PSDS) among others. However, despite these initiatives, many MSMEs still face financial constraints in their efforts to expand or even sustain their businesses. According to Okapara (2006), limited credit is the biggest constraint to the growth of MSMEs in Kenya. Accessing credit is difficult mainly due to high interest rates, the incomplete nature of credit trade in the country, credit unworthiness perception financial institutions have on MSMEs, and the lack of the awareness of available financial options. Furthermore, Berg et al. (2015) on their analysis of SME financing in Kenya, found that the lack of a structured analysis of financial numbers and characteristics of SMEs posed a difficulty for lenders to package viable financial options for MSMEs. The emergence of financial institutions like Micro-Financing Institutions (MFI) and Saccos may have eased the financial burdens of MSMEs in Kenya but due to their limited funds and the lack of refinancing from the Central Bank, they are unable to sustain the long-term financial needs of a growing enterprise (OECD, 2007).

It is apparent that MSMEs in Kenya have difficulty accessing financing. Being the most affected by the imperfect financial markets when compared to larger firms, it has been deduced that such financing obstacles could decrease an MSME's growth by 10% (Beck et al., 2006). They either

remain stagnant or fail because they are unable to make significant investments for the expansion of their product/service line or geographical coverage (Cabral and Mata, 2003). Furthermore, limited access to credit does not create room for flexible resource allocation and increases the negative effects of cash flow issues on an enterprise's activity (Bigsten et al., 2000). These financial constraints, in addition, deter some of those who would want to start new businesses from actually doing so.

One possible solution for these financial challenges is the use crowdfunding platforms. The World Bank (2015) report, *Crowdfunding in Emerging Markets, Lessons from East Africa* underlines that African developing countries do not utilise crowdfunding platforms as effectively as other countries. Although Africa showed a 101% growth rate in funding volume in 2015 and it is projected to continue to grow, this still represents less than 0.1% of the global crowdfunding activity and about 21 percent of emerging market activity (Afrikstart, 2016). It is the purpose of this study, to evaluate how crowdfunding can improve MSMEs' access to finance.

1.4 Research Objectives

The main objective of this study is to examine the effect of crowdfunding platforms in enhancing the financing sources for MSMEs in Kenya.

The specific objectives of the study are to:

- 1) To analyse the financing gap for MSMEs in Kenya.
- 2) To examine the challenges associated with sourcing of finance through crowdfunding platforms.
- 3) To determine the effect of crowdfunding platforms in narrowing the financing gap in MSMEs in Kenya

1.5. Research Questions

The following were the guiding questions:

- 1) What is the financing gap for MSMEs in Kenya?
- 2) What are the challenges faced by Kenyan MSMEs in accessing finance from the crowdfunding platforms?
- 3) To what extent does finance from crowdfunding platforms narrow the financing gap of MSMEs in Kenya?

1.6. Significance of the Study

For local entrepreneurs, the study will serve as a practical guide to entrepreneurs' looking to utilize the different types of crowdfunding platforms more effectively. For example, it will provide an analysis of challenges that were faced by local entrepreneurs' while accessing funds from the different types of crowdfunding platforms. It will also recommend the platform type with the highest success rate for Kenyan MSMEs when it comes to sourcing funds from the crowd. This study will shed some light on whether crowdfunding platforms offers a more efficient mechanism to deliver capital to local entrepreneurs in a way that leverages the existing infrastructure and community resources to support MSMEs (World Bank, 2013). Currently, there are no legal and regulatory frameworks which set crowdfunding platforms rules in Kenya and the absence thereof limits the expansion of crowdfunding platforms (Afrikstart, 2016). Hence, this study could also serve as reference for policymakers in developing policies and regulations that will govern MSME's exploitation of crowdfunding platforms. Furthermore, this study will add to the body of knowledge on MSME financing and crowdfunding platforms and provide future scholars with information.

1.7. Scope of Study

The study will focus its analysis on all the Kenyan MSMEs who have utilised crowdfunding platforms at least once therefore excluding all MSMEs who have never used crowdfunding platforms. The crowdfunding platforms that will be considered will be both the local and international platforms that are accessible to Kenyan MSMEs. The MSMEs in this case will be at all stages i.e. whether they are in their ideation, pilot, validation, growth or scale stage. For purposes of this study, as shown in section 1.1, the definition of MSMEs in Kenya will be restricted to those with a maximum number of 99 employees and a maximum turnover of Ksh 800 million. The MSME will have to be a registered company. The MSMEs will also be all those with 100% their operations in Kenya even though they may have foreign co-founder.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter forms the literature review. A review of various literature is undertaken and discussed in this chapter in line with the study objectives. The chapter also discusses the financing needs of MSMEs, the challenges they face focusing largely on inability to access financing from crowdfunding platforms and the extent to which the MSMEs who have accessed these platforms have been able to bridge their financing gap. The theoretical review and conceptual framework that inform the study and explain the influence of crowdfunding platforms in narrowing the financing gap of MSMEs is also outlined.

2.2 Theoretical Framework

The theoretical framework offers theories that expound on why the research problem under study, the financing gap in MSMEs, exists. In order to measure and determine the statistical relationships between adoption of crowdfunding platforms and the financing gap in MSMEs, this study will adopt two key theoretical frameworks.

Pecking Order Theory

According to this theory, firms circumvent external financing while they have internal financing available and avoid new equity financing (internal or external) while they can engage in new debt financing at reasonably low interest rates (Murray and Goyal, 2005). Internal financing, the most preferred source of finance, includes retained earnings or personal savings. Cosh and Hughes (1994), emphasize that the Pecking Order Theory is applicable to SMEs on the preference to use funds generated within the business instead of those generated externally. However because SMEs have less access to external funds when compared to large enterprises, SMEs seemingly experience a more acute rendition of the Pecking Order Theory known as a "constrained" Pecking Order (Holmes & Kent, 1991). It implies that using external funds correlates to the profitability of SMEs, in that if they are not stock exchange listed, they will first resort to utilizing internally generated funds while those which make use of external funds generally have a lower level of profit. It is probable that growth will drive SMEs with insufficient internal resources to borrow. Even if the pecking order is limited by lack of any external funding, SMEs might curb their growth to match available internal funds. It can also be concluded from the pecking order theory, considering the significance of retained funds, that startups will have less time to accumulate resources and so will need support from external sources such as crowdfunding platforms.

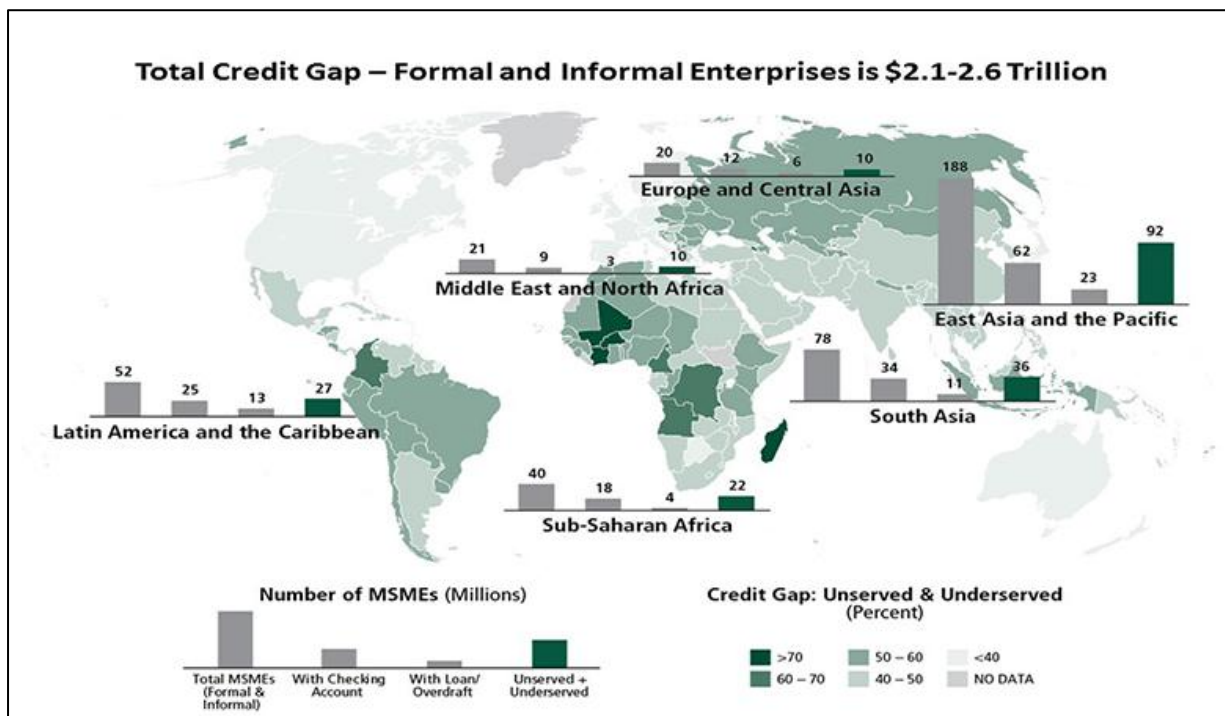
Theory of Financial Intermediation

The modern theory of financial intermediation analyses, mainly, the role of financial intermediation, the way in which the financial intermediation impacts the economy on the whole and the effects of government policies on the financial intermediaries. Crowdfunding platforms can be regarded as financial intermediaries. In contrast to traditional finance intermediation, crowdfunding platform intermediation is characterized by certain fundamental differences. First, in crowdfunding platform intermediation the funding judgement and funding activities is no longer reserved to professional financial institutions (banks, venture capitalists) but opened up to the public. Second, crowdfunding platform intermediation provides funding for ventures who would have struggled via traditional forms of funding by making use of information technology (Haas et al, 2015). Third in contrast to traditional financial intermediation, the crowdfunding platform intermediary is not involved in the actual funding process. By contrast it serves as a match maker by linking capital seekers and capital givers directly and by enabling them to exchange value and information. It is under the premise of this theory that we analyse the role of crowdfunding platforms as an alternative source of finance in narrowing the financing gap for MSMEs in Kenya.

2.3 The Financing Gap in MSMEs

Finance is a key input in the development and growth of MSMEs. It has been estimated that 80% of startups in Kenya for example fail in their first year with difficulty in accessing financing attributed as the major reason for this high statistic (Wanjohi, 2009). Approximately 70 percent of all MSMEs in emerging markets do not have access to credit. Although the gap is very different between regions, it's predominantly broad in Asia and Africa. The existing credit gap for formal MSMEs is projected to be US\$1.2 trillion while the total credit gap for both formal and informal MSMEs goes up to US\$2.6 trillion (World Bank, 2015).

Figure 2.1 Total Credit Gap



Adapted from World Bank 2015, p 17

According to Timmons and Spinelli (2007), harnessing financing and fund-raising strategies according to the available options, and securing funding are imperative to the steady existence and success of nearly all new MSMEs. Once the market opportunity and the approach to maximising it become clear, an entrepreneurial organization can then assess its financial needs. It will do so by first analyzing its asset requirements (facilities, equipment, research and development, and other one-off costs) followed by its operating requirements (i.e. working capital for operations) (Winton and Yerramilli, 2008). Zhou and Chen (2008) state that physical resources are important for new MSMEs so that they can make the most of the business opportunities. Opportunity discovery requires physical resources for fruition and lacking physical resources is a crucial failure factor for new MSMEs. They demand resources like fixed assets and working capital so as to attain a competitive advantage.

Other attributes of new MSMEs financial needs, as stated by Todor and Alin (2008) and Barringer and Ireland (2012), encompass initial losses owing to the product development costs and other sunk costs prior to operation, new product development, human capital development, training and technology. Furthermore, Robb and Robinson (2009) mention that financing is necessary for new MSMEs to sustain working capital. Entrepreneurs who are successful forecast their firms’ investment needs in order to suitably assess, pinpoint, negotiate, and build business relationships with the ability to generate funding sources. This is seemingly in line with Timmons’ and Spinelli’s (2007) point of view in that

the decision on the needed resources, the time they are needed and the ways to procure them are strategic decisions that correspond with other driving forces of entrepreneurship.

The traditional financing options accessible by new MSMEs, as stated by Schwienbacher and Larralde (2010), may be classified under debt and equity. Looking specifically at debt financing, it is seemingly unsuitable for newer, innovative and fast growing companies, with a higher risk-return profile. Commonly, the “financing gap” that influences these businesses is a “growth capital gap”. Large sums of funds may perhaps be required to finance projects with high growth projections, while the accompanying profit patterns are rarely easy to predict. At this stage, if an MSME is experiencing rapid growth, an over-dependancy on short-term finance could result in illiquidity. Hence, a growing MSME would, therefore, have to either reduce its growth to sustain its internally generated funds, acquire a costly stock market quotation, or seek venture capital. This means that the MSME would either have higher levels of short-term debt, or in few cases have long-term debt. In scenarios where short-term debt replaces unavailable equity issues, they would have higher total debt. Growth after flotation would possibly have less of an effect on capital structure since they can raise finance in a balanced way, including long-term debt and equity, instead of relying on short-term debt (World Bank & KIPPRA, 2004).

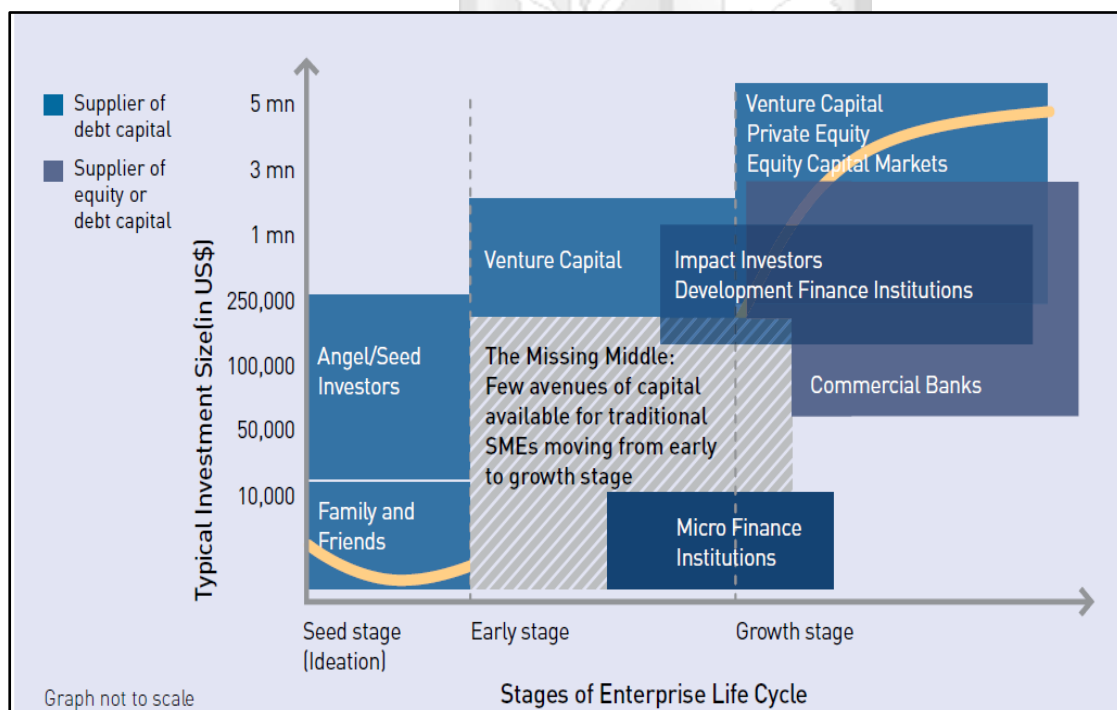
The Key MSME finance providers in Kenya comprise of Risk Fund Managers, Venture Capital Funds and Private Equity funds, Banks, Investment clubs, Micro Finance Institutions, leasing companies and Technical Assistance funds. One survey showed that bank (debt) financing makes up 86% of the total demand for funds, while only 0.58% of MSMEs used equity finance (CMA, 2010). Although Kenya is considered the most favourable destination for private equity investment after South Africa and Nigeria, the majority (of approximately 15–20 active private equity funds) are mainly directed to larger SMEs, with financing needs of between US\$50,000 and \$5mn (Deloitte & Africa Assets, 2014), excluding the remainder of Kenya’s MSME sector.

The difficulty in accessing debt financing from banks and other formal financial institutions for majority of Kenyan MSMEs has been mainly attributed to lack proper financial records or information on the MSME in general. Many businesses frequently keep multiple sets of books and do not have audited financial statements hinged on reliable accounting standards. These MSMEs may eventually get loans at higher interest rates because formal institutions consider them as high risk borrowers (Wanjohi 2009). Other constraints include high transaction costs, high collateral requirements and lack of guarantee credit instruments, deficiencies in legal systems and regulatory and policy problems. In addition, SMEs in Africa largely remain an unattractive investment for mainstream investors as

investors are concerned about the country, currency and credit risks characteristics of many African countries in which SMEs operate (Afrikstart, 2016). The financing constrictions can especially be severe in start-ups or small businesses that are dependent on intangibles in their business model, as these are very firm-specific and not easy to use as collateral in traditional debt associations (OECD, 2010a).

Consequently as an alternative, MSMEs depend on internal or “personal” funds to kick off and manage their enterprises at the outset. Issakson and Willhborg (2002), while studying the financial constraints to Kenyan manufacturing firms, found that most firms lend from friends and/or relatives. Another survey sponsored by the Danish government and released in Kenya, on April 2010, found out that players in this sector are dissatisfied with access to finance especially from major financial institutions in Kenya. However, there has been a number of initiatives from non-governmental organisations (NGOs) and donor-funded public-private partnerships to support MSMEs, more so startups (Papadavid, 2016). In the Kenyan context therefore, the situationality of the challenges associated with accessing the various financial sources gives rise to a missing middle or financing gap (Intellectap, 2015) as shown in the diagram below.

Figure 2.2 Total Credit Gap



Adapted from Intellectap 2015, p 40

From the researchers' analysis of Figure 2.2 it is safe to say the limited supply of credit is the main contributor to the financing gap faced by MSMEs in Kenya. The small number of options to traditional debt is a representation of a significant challenge faced by policy makers in pursuit of viable recovery and long standing growth, since these companies are habitually at the front position in job creation, the implementation of new technologies and the development of new business models (OECD, 2006).. In addition, reinforcing the access to finance constraints that MSMEs have and determining ways through which they can access sources of capital is essential in enabling the growth of this potentially dynamic sector and providing the necessary jobs. The development of other financing systems could be applicable to the larger MSMEs and micro-enterprises population even though alternatives to traditional debt finance are specifically imperative for start-ups, high-growth and innovative MSMEs.

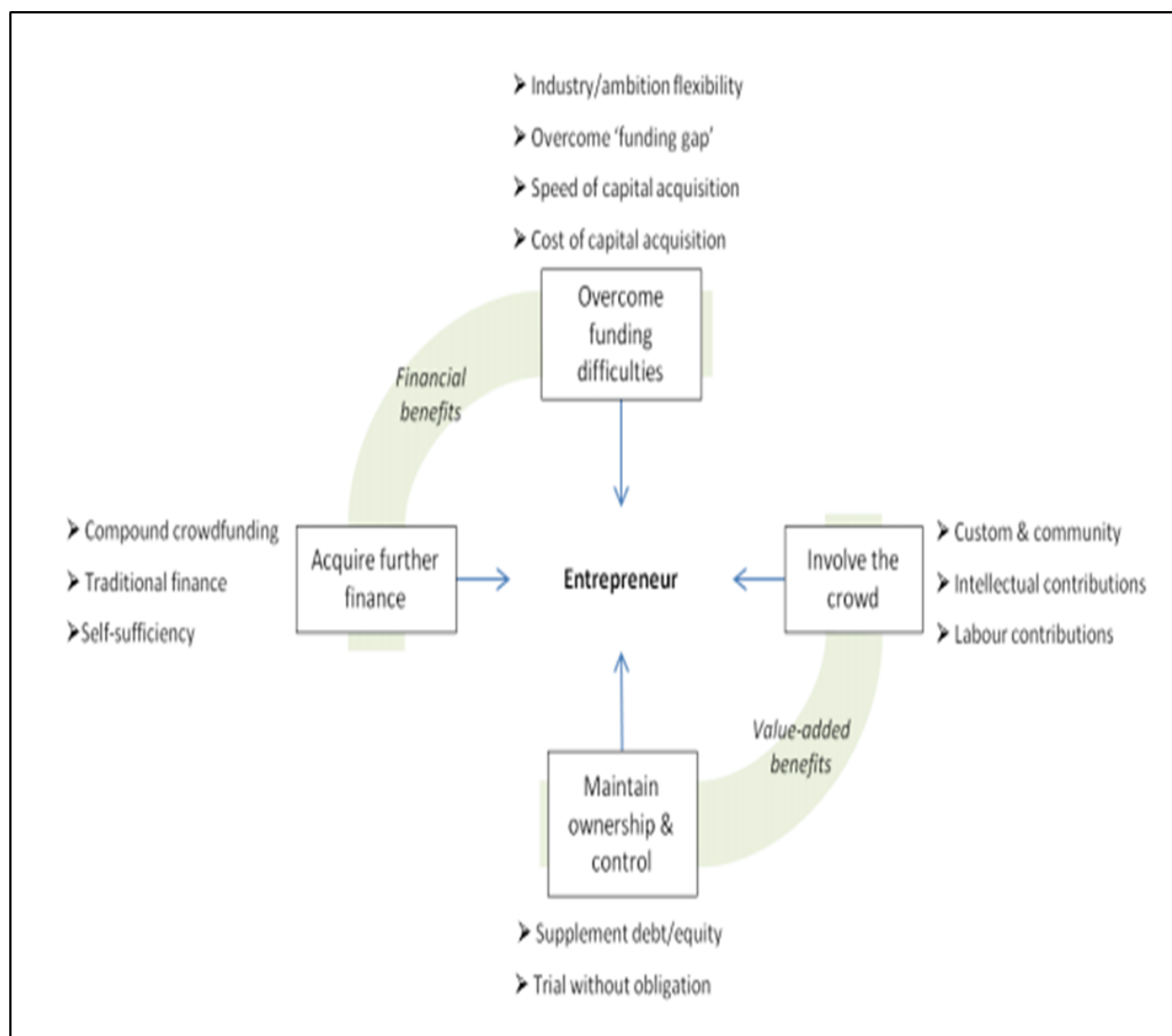
Thus, it is important to augment the variety of financing instruments available to MSMEs and entrepreneurs including alternatives like crowdfunding platforms so that they can keep playing their role in innovation, growth and job creation. It has also been observed that Kenya has a weak enterprise finance information system that could not particularly support the information needs of small business enterprises where general knowledge and awareness of finance options available is unsatisfactory (Migro & Wallis, 2006). There is a need for targeted awareness and educational schemes to inform MSMEs of options like crowdfunding platforms that could go a long way in addressing the missing middle by providing capital for traditional SMEs moving from early stage to growth stage.

2.4 Effect of Crowdfunding Platforms in Narrowing the Financing Gap

Crowdfunding platforms have fundamentally impacted entrepreneurial finance by providing a new alternative to equity, debt and informal borrowing allowing entrepreneurs to leverage 'the crowd' so as to generate financial investment (Belleflamme et al., 2014). After social causes, businesses and entrepreneurship is the highest performing category (Massolution, 2013). This is expected as crowdfunding platforms have proven effective in narrowing the financing gap MSMEs face. Based on the findings of Macht and Weatherston (2014), crowdfunding platforms offer unique opportunities in narrowing the gap for MSMEs especially due to the lack of restrictions on the nature of the firms that can get involved. Other than the funding they received from their funding campaigns, entrepreneurs undoubtedly received further funding either by the pursuit of external funding by the entrepreneur later on, or simply elevating the business to a position of self-sufficiency. An MSME can use a successful crowdfunding campaign as leverage to getting funding from other external sources. In overcoming the 'funding gap', it may receive interest from traditional funding vehicles as it becomes perceived as being 'investment ready' (Mason and Harrison, 2004). On a lending platform, Zhan and Liu (2012) found evidence of herding among lenders meaning that well-funded borrowers typically attract more

funding. Crowdfunding platforms also indirectly narrow the financing gap by reducing the marketing and customer acquisition costs an MSME, especially startups, would have to incur. Through their campaign they can not only trial a concept without the financial and monitoring obligations that other funding sources require, but also use it as an advertising device. Figure shows how crowdfunding platforms benefits MSMEs, including other value added benefits like feedback from contributors to improve on their products or business models.

Figure 2.3 Benefits of Crowdfunding Platforms



Adapted from Macht and Weatherston (2014)

Consistent with the Crowdfunding Centre (2015) report, scrutiny of the success rates of campaigns from five of the major crowdfunding platforms in U.S., U.K. and Canada, Kickstarter, the New York City Kleenex brand of crowdfunding, had 31 percent of its campaigns attain their 2015 fundraising

objectives. That's the highest success rate amongst the five crowdfunding platforms incorporated in the study.

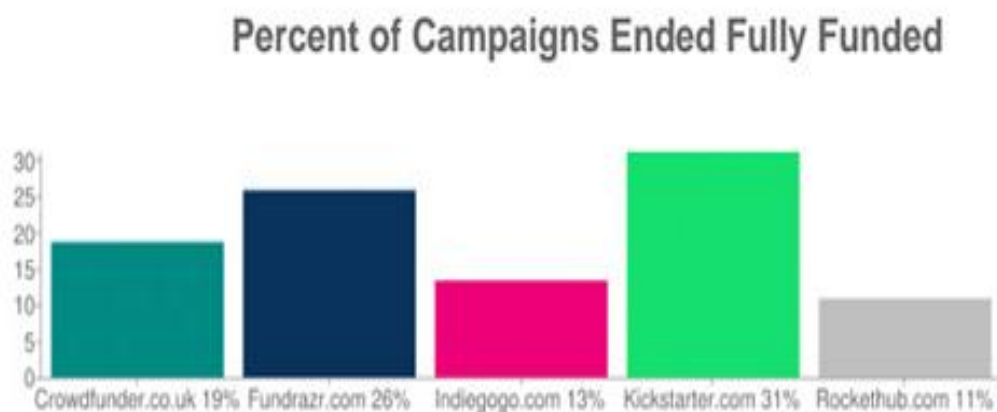


Figure 2.4 Percentage of projects that reached their target by platform during Jan-Dec 2015, Crowdfunding Centre (2015), p 10

Twenty six percent of crowdfunding platform campaigns on FundRazr (headquartered in Vancouver, Canada), as stated in the report, attained their 2015 campaign goals. U.K.-based Crowdfunder had 19 percent of its campaigns meet goals, Indiegogo (headquartered in San Francisco) had a 13 percent fully-funded success rate and RocketHub (headquartered in New York City) had only 11 percent of campaigns attain their campaign goals.

According to Massolution's 2012 Crowdfunding Industry Report, the global average success rate for crowdfunding platform campaigns in 2012 was around 50%. On the other hand, the rate of failure is relatively high. For example, by early 2014, Kickstarter lists about 57% of failed projects – that is, not reaching their initial funding goal. These studies however do not differentiate the success rates between campaigns from enterprises (MSMEs) and those from individual social or personal causes. No study has been conducted on success rates achieved by Kenyan MSMEs in accessing funding from the various crowdfunding platforms accessible to Kenyan entrepreneurs'. In this study therefore, we will seek to examine the average success rates of Kenyan MSMEs who have used crowdfunding platforms to access financing.

2.5. Challenges Faced in Accessing Funding through Crowdfunding Platforms

In line with World Bank (2015), crowdfunding is an exciting concept for entrepreneurs who see it as a solution to the constraints of traditional access to finance. Still, crowdfunding from these platforms is not easy and necessitates substantial dedication of time and resources, more so in areas, such as East Africa, where crowdfunding platform concept is still new. The report on crowdfunding in *Emerging Markets, Lessons from East Africa Start Ups* provides a summary of some of the main lessons learnt on crowdfunding in East Africa and these lessons have been outlined below.

First lesson learnt is that use crowdfunding platforms is not for everyone and not as easy as most entrepreneurs anticipate. Substantial amounts of human effort is needed for a successful campaign. It is essential for entrepreneurs to investigate other crowdfunding platforms campaigns in the same sector or geographical region to comprehend their expectations and judiciously put into consideration the opportunity costs of crowdfunding platforms in comparison to other obtainable sources of capital. Mollick's (2014) demonstrated that geographic clusters are still evident in the use of crowdfunding platforms and determine the type of crowdfunded project and their success.

The second lesson learnt is that, the selected platform should be determined by business requirements. Entrepreneurs have to accurately examine the amount of capital obtainable from crowdfunding platforms serving their geographic areas. It is rare to find debt and equity platforms that normally facilitate larger amounts of funding in several emerging markets.

Thirdly, payment systems have an influence on the platform choice. The forefront international crowdfunding platforms habitually have limitations on who can launch campaigns. They also put into place payment systems that hinder contributions from the developing world. Local-based platforms are more suitable for engaging the developing world, but do not have a large pool of possible contributors.

The fourth lesson learnt is that quality and quantity of contributor networks are vital. It is important that entrepreneurs spend a lot of time establishing a contact base that will fund capital and endorse the campaign. Moreover, the likelihood of attaining fundraising goals is augmented for entrepreneurs who can “pre-raise” funds from their current networks prior to a campaign going live.

The fifth lesson learnt is that, entrepreneurs must venture into complementary resources and organizations to upsurge their prospects of success. Business mentors and incubators can be

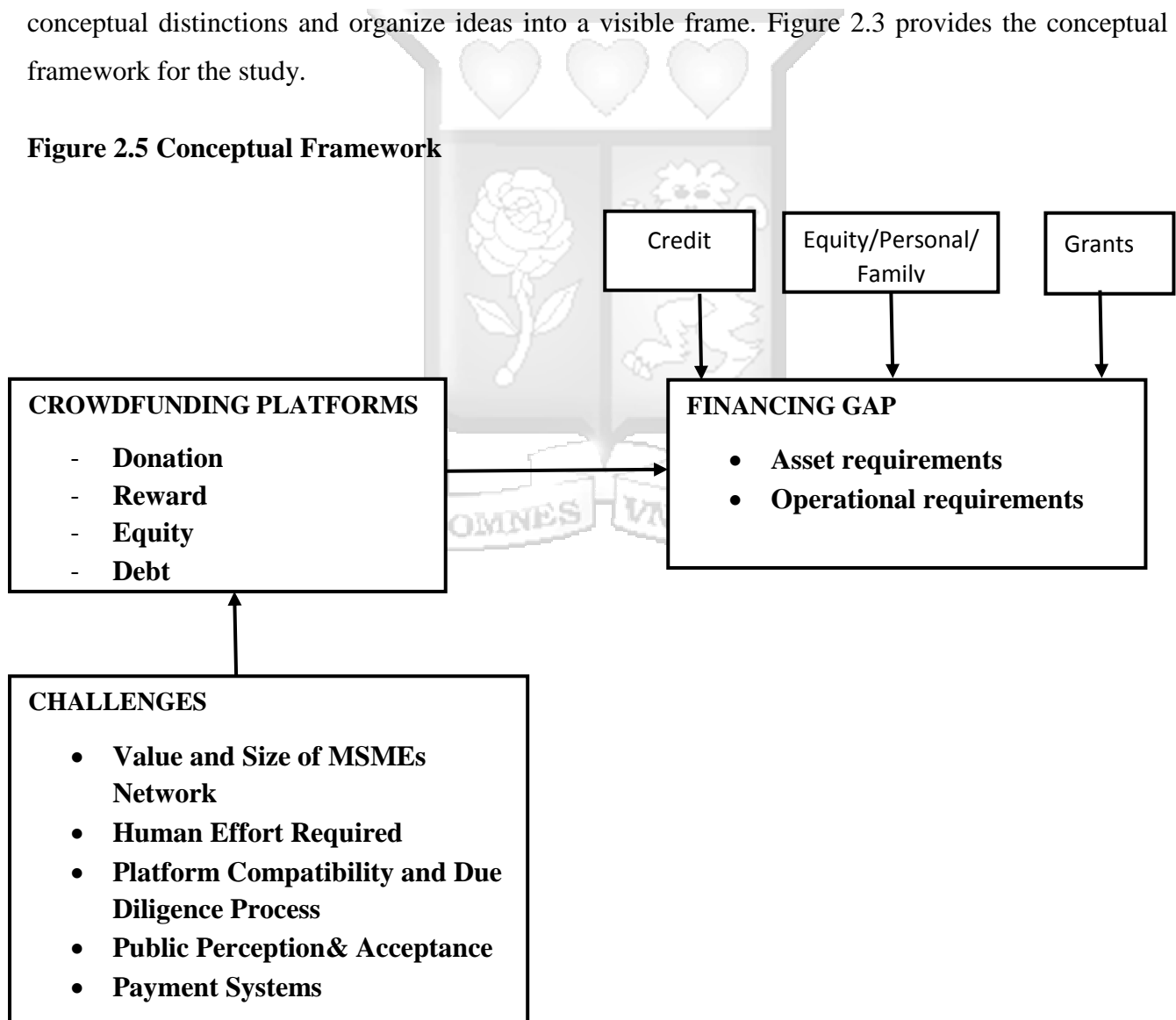
indispensable sources of information and support for new crowd-funders. Complementary funds have shown to be efficient in incentivizing local contributors to distribute their funds through digital platforms.

These lessons or challenges are not particularly specific to Kenyan MSMEs and it is unclear the extent to which these challenges influence the MSMEs ability to access funding from the crowdfunding platforms. Further, it is unclear which platform types are particularly affected by each of this challenges.

2.6. Conceptual Framework

A conceptual framework is an analytical tool with several variations and contexts and is used to make conceptual distinctions and organize ideas into a visible frame. Figure 2.3 provides the conceptual framework for the study.

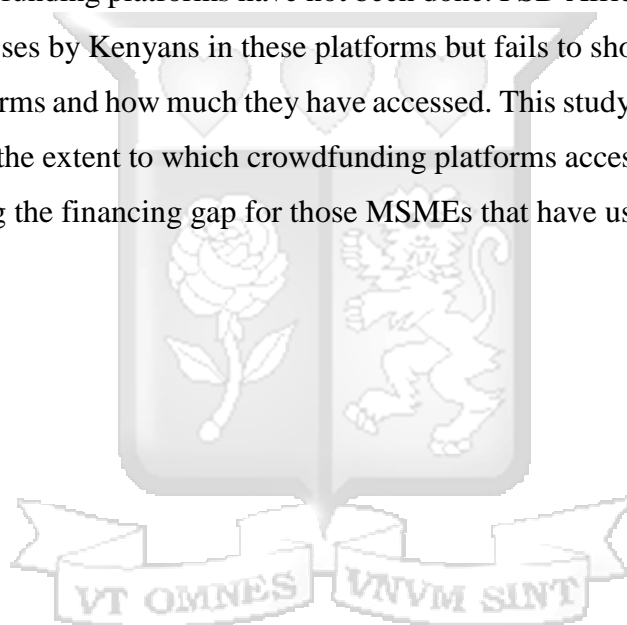
Figure 2.5 Conceptual Framework



Research Gaps

The literature reviewed for the purpose of this study has shown that MSMEs experience serious challenges in meeting their financing needs hence the presence of a financing gap. Financing is a significant restraint to SME growth and without it, several MSMEs suffer and stagnate. (World Bank, 2015)

Digital solutions such as crowdfunding platforms are increasingly being adopted to bridge the financial gap, however, none of the previous studies have focused on the effect of crowdfunding platforms in narrowing the financing gaps for MSMEs particularly in Kenya. Furthermore, studies trying to understand the level of finances being raised and success rates being achieved by Kenyan MSMEs while accessing the crowdfunding platforms have not been done. FSD Africa (2016) attempts to study the level of finances accessed by Kenyans in these platforms but fails to show which Kenyan MSMEs have accessed these platforms and how much they have accessed. This study therefore seeks to provide the motivation to explore the extent to which crowdfunding platforms accessible to MSMEs in Kenya have assisted in narrowing the financing gap for those MSMEs that have used these platforms.



CHAPTER THREE

RESEARCH METHDODOLOGY

3.1. Introduction

This chapter outlines and discusses the research methodology that was employed to meet the research objective of analysing the effect of crowdfunding platforms in narrowing the financing gap for MSMEs in Kenya. It provides insight on the study population, data collection instruments and procedures, method of data analysis and data validity.

3.2 Research Design

According to Kothari (2004), a research is an outline of how the objectives of a study are met and the specific problems under investigation. To achieve the proposed research objective of analysing the effect of crowdfunding platforms in narrowing the financing gap for MSMEs in Kenya the empirical design selected for this study was an exploratory research design by surveying concerning literature, administering questionnaires and analysis of stimulating insights. According Burns and Bush (2006) exploratory research design is referred as gathering information in an informal and unstructured manner. The exploratory research design is proper when the researchers knows small about the opportunity or issue. Exploratory research design is not limited to one specific paradigm but may use either qualitative or quantitative approaches.

The main difference between descriptive and exploratory research is that unlike, exploratory research, descriptive research formulates a hypothesis in advance. Kirsch G (1992) say that who, what, where, when and how questions are answered by descriptive research. Descriptive research deals with everything that can be measure or counted. Thus, since the research questions are broad and there is no specific hypothesis this affirmation led the researcher to settle on exploratory research design.

3.3 Population

According to Cooper and Schindler, (2013), a population is the total collection of elements we wish to infer. This can be a group of individuals, persons, objects, or items from which samples are taken for measurement. The population for the primary research includes all Kenyan MSMEs that have used any of the crowdfunding platforms that are accessible to Kenyans at least once. For purposes of this study, as noted in section 1.1, the definition of MSMEs in Kenya was restricted to those having a maximum number of 99 employees and a maximum turnover of Ksh 800 million and have 100% of their operations in Kenya. FSD Africa (2016) reports that there are a total of **48** crowdfunding platforms accessible to Kenyan MSMEs. The population size of these MSMEs, through desktop research of the **48** platforms, reveals that only **30** Kenyan MSMEs have accessed funding from these

crowdfunding platforms. The names of these platforms and the corresponding MSMEs is shown in **Appendix 1** of this study.

3.4 Sample Size and Sampling Procedures

3.4.1 Sample size

Devote (2008) defines a sample as a set of data that is obtained from a statistical population using specified data collection techniques. In this study, the sample size was equal to the population size since the population was small with only a possible 30 respondents. The target MSMEs and crowd funding platforms have been provided in **Appendix 1**.

3.4.2 Response rate

The response rate for this study was 96.7% .This was calculated based on the number of questionnaires administered and those that were submitted back duly answered and were used for data analysis. **Table 3.1** gives the findings.

Table 3.1 Response rate

	Frequency	Percentage (%)
Responded	29	96.7%
Did Not Respond	1	3.3%
Total	30	100%

3.5. Data Collection

Saunders et al., (2003) defines data collection as the method through which the researcher gathers desired information from a specific population for presentation in a conventional way; in such a manner that it is relevant to answering the research questions. As stated earlier, the study employed surveying concerning literature, administering questionnaires and analysis of stimulating insights. The use of a questionnaire was however the main research instrument for the target respondent. In some instances the questionnaire was physically administered. The questionnaire was divided into three distinct sections; the first on the demographic information of respondents and business while the outline of the other two was based on two research objectives; assessment of the challenges faced by Kenyan based MSMEs in accessing crowdfunding platforms and the effect of crowdfunding platforms in narrowing the financing gap for target respondents. The questionnaire also allowed use of Likert scale type questions thereby enhancing the quality of information gathered and affirming its selection for this study. Secondary data was also collected by surveying concerning literature in order to analyse the average financing gap of an MSME at a country level.

3.6. Data Validity

This can be defined as the quality attributed to a proposition or measures of the degree to which a research instruments conforms to establish knowledge or truth (Paton, 2000). In essence, validity of a research instrument is concerned with the extent to which it can measure what it purports to measure. It refers to the extent to which a research instrument asks the right questions in terms of accuracy. Validity is the accuracy and meaningfulness of any inferences that are founded from research results (Mugenda and Mugenda, 2009).

In this study, content validity was employed to determine the validity of the questionnaires. Before undertaking the field study, the researcher first carried out a pilot study by targeting 5 randomly selected MSMEs. This proved necessary as it helped clarify on wording and grammar in the questions, in turn ensuring that the final questionnaire had no misinterpretations. Piloting of the questionnaires revealed a number of ambiguous questions that the researcher was able to correct. As a result of the pilot the researcher is confident that data used in this analysis is valid.

3.7 Data Analysis

Data analysis can be defined as the process of evaluating data using analytical and logical reasoning so as to determine every variable in the study. As such it entails the process of gathering data from its various sources, its review and analysis so as to possibly form a deduction. The data gathered in this study was both quantitative and qualitative. An advanced version of Microsoft Excel MTAB was used to analyse the data.

3.8 Ethical Considerations

The participants in this study did so out of their own volition. Their right to refuse to either be interviewed or to answer all or some of the questions given was respected. At the same time all the information gathered during the time of this study was considered and treated as confidential and was only used in meeting the research objectives. Formal approval was also obtained from the Strathmore Business School to conduct the research.

CHAPTER FOUR

DATA ANALYSIS, INTERPRETATION AND DISCUSSION

4.1 Introduction

This chapter provides the presentation, analysis and interpretation of the data collected during the field study as well as data collected from secondary research. The purpose of the data analysis was to determine the average financing gap that exists in MSMEs in Kenya and the effect that crowdfunding platforms played in improving financing opportunities for the MSMEs that accessed them. Secondary data was collected from the World Bank and Central Bank of Kenya to determine the average MSME financing gap at a national level. From the primary data, the average success rates of the four different types of crowdfunding platforms was determined as percentage of amounts raised from the platform versus the target amounts the entrepreneurs' were seeking from these platforms. The average success rate for each platform was then applied to national average financing gap to provide a recommendation on which platform could be an ideal contributor in narrowing the financing gap for MSMEs in Kenya. The researcher also analysed the challenges faced by MSMEs when sourcing funds from the crowdfunding platforms and the extent to which these challenges vary with the platform type.

4.2 Demographic Information

In this section, the demographic representation of the respondents as surveyed during the field study has been discussed. Key demographic information surveyed includes; co-founder nationality, type of business, duration the business has been in existence, amongst others. Questionnaire were administered to the target population of (30) out of which(29) were able to participate giving a response rate of 96.7%; one that the researcher considers as adequate to meet the research objectives. This is as affirmed by Smith (2002), Saunders et al. (2012) and further reinforced by Johnson and Owens (n.d), who opine that disclosure of response rate is a necessary condition for scholars. They go ahead to provide for “*at least a 60% response rate with rare exceptions*” as a tenable response rate in research surveys. The analysis of the demographic information was important as it provides insight on the type of entrepreneurs and influence on the ability of these entrepreneurs' to access funding from the crowdfunding platforms.

4.2.1 Co-founder nationality

It is important to look at the co-founder Nationality as it may influence the ability to attract funding from the crowdfunding platforms. The table below illustrates whether there exists the presence of a non-Kenyan co-founder in the business as follows. The co-founder nationality is important as it may influence the entrepreneurs' ability to attract funds from international networks.

Table 4.1 Co-founder nationality

Co-founder nationality	Count	Percent
Foreign	10	34.45
Kenyan	19	65.52
Total	29	100%

4.2.2 Type of business

To be able to determine the type of business carried out by the 29 MSMEs, the researcher grouped the responses into five categories; agribusiness, manufacturing, renewable energy, retail, and technology business. The manufacturing category considered those companies that are involved manufacturing and are not primarily agribusiness or renewable energy business even though the latter may have some form of manufacturing. In total, technology business comprised of 6.9%, manufacturing 10.34%, renewable energy 55.1%, retail 10.3 % and finally agribusiness comprised of 17.2 %.The findings presented in **Table 4.2** show that most of the MSMEs that have accessed funding from crowdfunding platform primarily are in renewable energy while those that are in technology business forming the smallest composition.

Table 4.2 Type of business

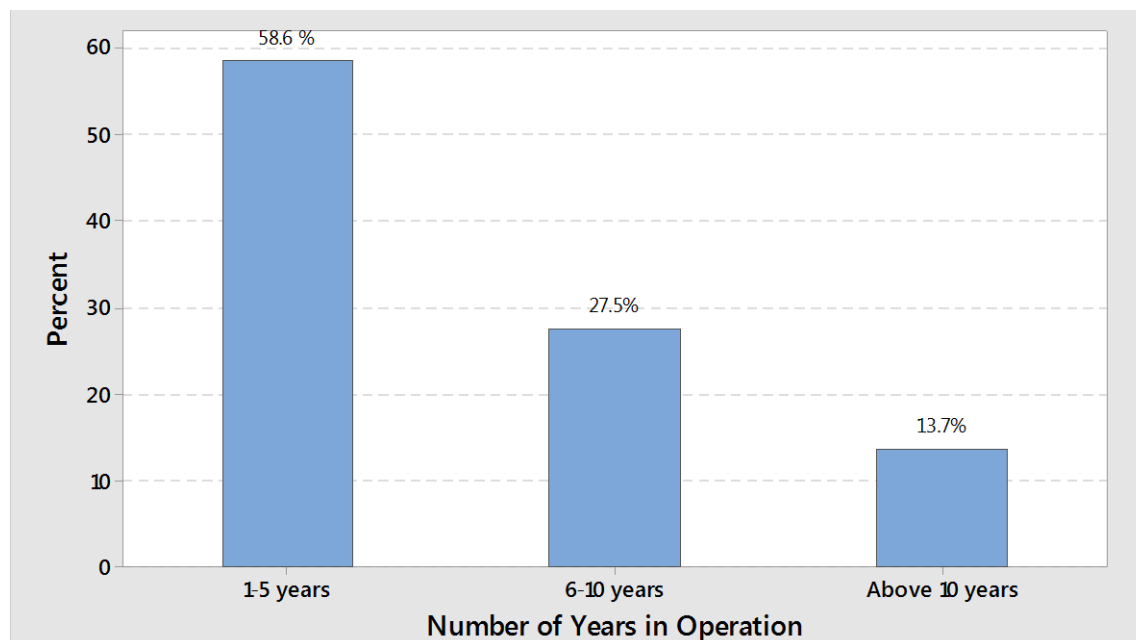
The Type of business	Frequency	Percent
Agribusiness	5	17.2
Manufacturing	3	10.3
Renewable Energy	16	55.2
Retail Business	3	10.3
Technology business	2	6.9
Total	29	100%

4.2.3 Number of years business had been in operation

According to the study findings shown in **Figure 4.1**, most of the businesses, 65.4%, had been in operation for between 1-3 years. Twenty eight point one percent (28.1%) had been in operation for between 4-6 years with 5.5% in business for over 6 years and 0.9% for less than one year. Cumulatively, 98.1% of the business had been in operation for over one and half years. This high percentage of business in operation for over one and half years gives the researcher confidence that the study population could be relied on to meet the research objectives. The nature of the study is such

that it is reliant on information gained over time. Thus the length of time the business had been in operation is a basis for valid inferences.

Figure 4.1 Duration MSME had been in Existence



4.2.4 Number of employees

The findings of this study indicate that most of the MSMEs (51.7 %) had 1 – 9 employees, followed by 13.7 % with 10 – 20 employees; 10.3 % had 21 – 30 employees while 20.6 % had 31-40 employees while 3.4 % had Above 50 but less than 100 employees.

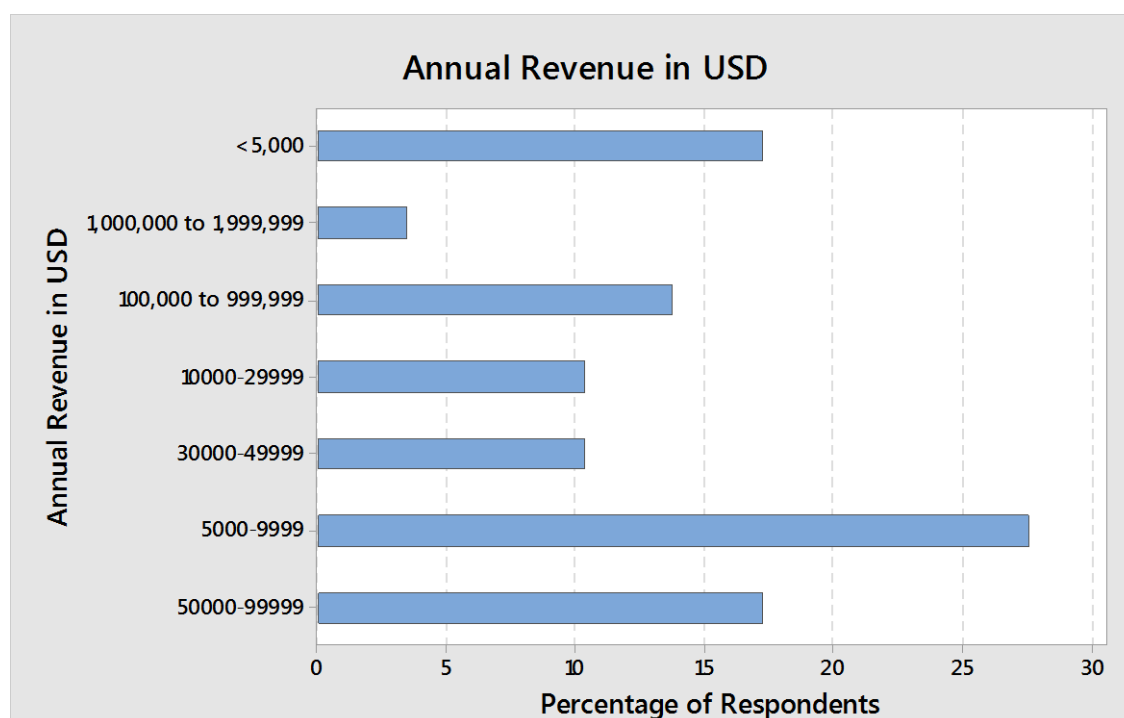
Table 4.3 Number of employees

Number of employee	Frequency	Percent
1 to 9	15	51.7
10 to 20	4	13.7
21 to 30	3	10.3
31 to 50	6	20.6
50-99	1	3.4
Total	29	100%

4.2.5 Annual Revenue

The findings of this study indicate that most of the MSMEs 17.2% had annual revenue of <5,000, while 27.5 % had 5,000- 9,999 , followed by 10.3 % with revenues 10,000-29,999; 10.3 % had revenues between 30,000-49,999 , 17.2 % had between 50,000-99,999 ,13,8% had revenues between 100,000 to 999,999 and finally 3.45% had revenues between 1,000,000 to 1,999,999.

Figure 4.2 Annual Revenue in USD



4.3 Financing Gap for MSMEs in Kenya

Secondary data from the World Bank and Central Bank of Kenya to be able to determine the average financing gap for MSMEs in Kenya. **Section 2.3** of the literature review “**the missing middle, Intellectap 2015**” shows the financing gap as a gap faced by MSMEs due to their inability to access credit from MFIs, Banks and other lending institutions. **Table 4.4** shows the researchers’ analysis of the financing gap which is found to be equal to **USD 7.1 billion dollars**. The total number of registered MSMEs not accessing loans from the same table is **940,020**. The average gap therefore is **USD 7,545** per registered but underserved MSMEs.

Table 4.4 Analysis of the Financing Gap

	Micro	Small	Medium	Total
Number of registered enterprises	890,000	120,000	10,000	1,020,000
Ratio of loan accounts to deposit accounts	6%	20.2%	23.4%	50%
Average loan size in USD	5,885	18,766	54,322	26,

	Micro	Small	Medium	Total
Number of MSMEs accessing bank loans	53,400	24,240	2,340	79,980
Number of MSMEs not accessing loans	836,600	95,760	7,660	940,020
Financing gap from Banks(USD)	4,923,298,974	1,797,017,796	416,109,967	7,136,426,737
Debt Supply from MFIs				44,000,000
Total Financing Gap				7,092,426,737

Adapted from World Bank 2013, Central Bank of Kenya 2015

This financing gap can either be estimated through a supply side estimation or a demand side estimation Central Bank of Kenya, 2015. World Bank 2013 data survey through a sampling process attempts a demand side estimation by sampling 69 MSMEs in Nairobi, Mombasa and Nakuru. Due to the limitation of data using a demand side estimation, the researcher opted for a supply side estimation of the financing gap. Intelicap 2015, provides a guide to this type of estimation that involve first estimating the size of Kenya's MSME sector, secondly estimating the level of access to credit and average loan size and lastly using these numbers to come up with an estimate of the financing gap. The researcher in this section adopted this sequential method of estimation.

As with the definitions, there is also inconsistency with estimates of the SME market size. Estimations of the SME opportunity vary among stakeholders. According to conservative estimations which includes the micro enterprise segment as well, there are 2.3 mn MSMEs in Kenya **Table 4.5**). The MSME Authority, on the other hand, during the interview for this research, shared that it estimates a total of 12.6 mn MSMEs, excluding the agricultural sector. Moreover, around 90% of the businesses in Kenya are unregistered and operate in the informal sector, making data availability a challenge. As per IFC data obtained through the link <https://finances.worldbank.org/Other/IFC-Enterprise-Finance-Gap-Database-Raw-Data/2ppx-k958/data>, only 13% or 134,000 enterprises out of Kenya's total registered enterprises are small and medium in size, whereas the large majority of 2.2 mn MSMEs are either micro-enterprises or part of the informal economy. In the absence of data, banks, investors and other financial institutions seeking to address this segment come up with their own estimates applying criteria that suit their business purposes. This study adopted the IFC classification.

Table 4.5 Number of MSMEs in Kenya

	Micro	Small	Medium	Total
Registered MSMEs (Thousands)	890,000	120,000	10,000	1,020,000
Unregistered MSMEs (Thousands)	1,270,000			1,270,000
Total				2,300,000

Adapted from IFC Enterprise Finance Gap Data Survey, 2010.

Secondary data obtained from Central Bank of Kenya 2015 “*Bank Financing of SMEs in Kenya*” through the link <https://www.centralbank.go.ke/reports/bank-supervision-and-banking-sector-reports/> reveals that a first level of analysis can be conducted by looking at the simple ratio between the number of loan accounts and deposit accounts for business customers, which can shed light on the percentage of firms with access to a credit facility. This kind of question is normally addressed via demand-side surveys with the question “Have you received a loan from a bank in the last ‘x’ years?” directly posed to the firms interviewed. However looking at the same question from a supply-side point of view can shed light on the validity of results: out of all businesses with a deposit account at a bank, how many are granted access to a loan?

Another interesting estimation from the supply-side survey according to the Central Bank of Kenya, 2015 concerns the average loan size provided to different categories of businesses. While the median value is more representative because it is less affected by outliers, the segmentation of the data by firm size should minimize this problem. **Table 4.5** shows that the average loan size was approximately KSh590,000 for micro-enterprises, KSh1.9 million for small firms, KSh5.4 million for medium enterprises, and about Ksh41 million for large firms.

It is important to note that this estimation is affected by many factors: first, many microenterprises may be borrowing from a personal account rather than a business account. Second, a business could have multiple deposit accounts at different institutions but receives a loan from only one or from none of them. Third, businesses could have only one deposit account with a bank which is providing multiple loans at the same time (e.g. an overdraft and a term-loan simultaneously). The first and second situations are likely to be more common in the Kenyan market, which is characterised by customer mobility and therefore businesses often have more than one deposit account.

Table 4.6 Access to Credit and Average Loan Size by MSMEs

	Micro	Small	Medium
Ratio of loan accounts to deposit accounts	6%	20.2%	23.4%
Average Loan size in USD	5,885	18,766	54,322

Survey of Data Responses, Central Bank of Kenya, 2015

Table 4.6 highlight the level of supply of credit to MSMEs by commercial banks and excludes Micro Finance Institutions which also play a significant role in providing credit to MSMEs.

According to the report by Association of Microfinance Institutions Kenya (2014) *Sector report on the Microfinance Sector in Kenya* accessed through the link <http://amfikkenya.com/management/> and further verification of the same, the annual debt supply from MFIs, is approximately USD 44 million .

4.4 Challenges Faced by MSMEs in Sourcing Funds from Crowd funding Platforms

Section 2.5 makes reference to a World Bank (2015) report crowdfunding in *Emerging Markets, Lessons from East Africa Start Ups* that provides a summary of some of the main challenges experienced by MSMEs raising funds through crowdfunding in East Africa. The main research gap identified however was to what extent these challenges affect the Kenyan MSMEs and whether there could be other factors such as the type of platform used, the entrepreneur nationality amongst others influence the type of challenge an entrepreneur may face. **Table 4.7** shows a summary of the challenges faced and the extent to which the respondents face them. From the table the value of the MSMEs network is the highest challenge that affects the MSME to a very great extent at 65.5%. This is followed by the lack of public knowledge and acceptance of crowdfunding platforms at 27.6% and human resource effort required at 13.8%. In this section we attempt to explore these three main challenges in detail by analysing to what extent they are influenced by the choice of platform.

Table 4.4 Challenges faced by MSMEs

Challenges Faced by MSMEs while Sourcing Funds from Crowdfunding Platforms		Very Small Extent	Small Extent	Great Extent	Very Great Extent	Total
Lack of local public knowledge and acceptance of crowdfunding platforms	n	3	12	6	8	29
	%	10.3	41.4	20.7	27.6	100
Human Effort Required (Campaign execution, developing quality content, plan outreach)	n	0	10	15	4	29
	%	0	34.5	51.7	13.8	100

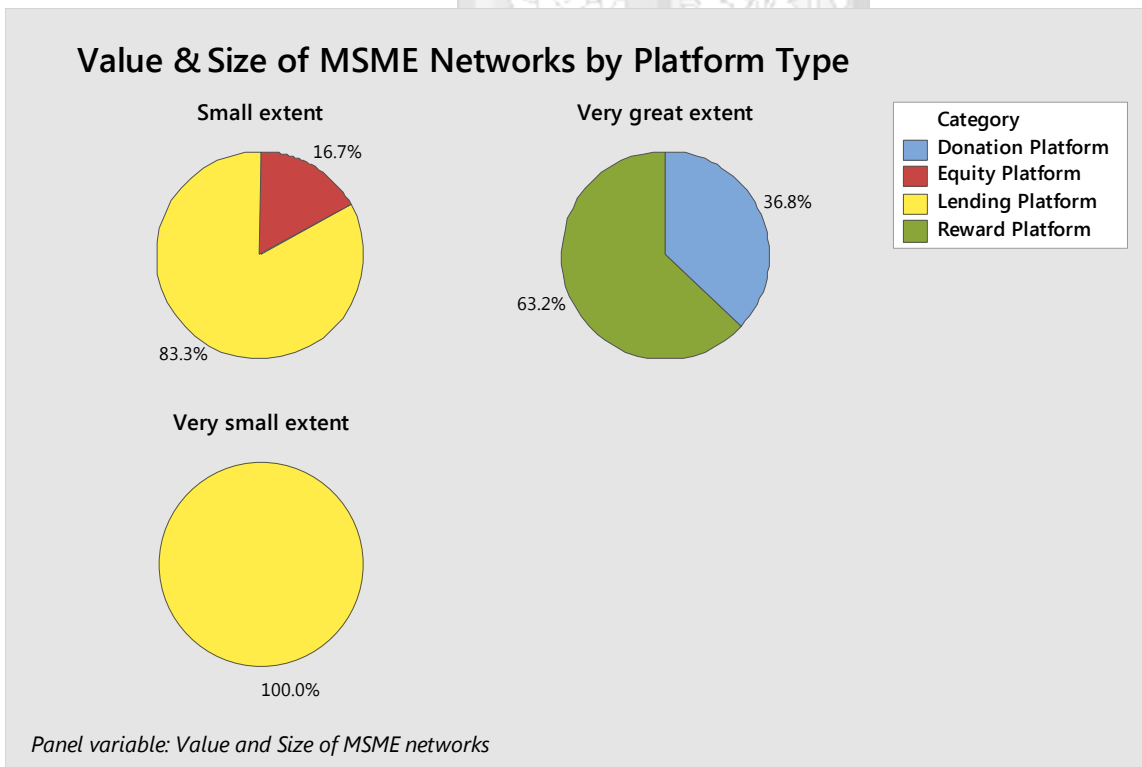
Lack of Compatible Payment Systems for International Platforms	n	11	6	12	0	29
	%	37.9	20.7	41.4	0	100
Value and Size of MSME networks	n	4	6	0	19	29
	%	13.8	20.7	0	65.5	100
Platform Compatibility and Due Diligence Process	n	7	12	9	1	29
	%	24.1	41.4	31.0	3.4	100

Where n- refers to sample size.

4.4.1 Value of MSMEs network

The value and size of the MSMEs network is defined by the MSMEs quality and quantity of contributor networks .It affects the MSMEs success in raising funds from the crowdfunding platforms. **Figure 4.3** shows that the 65.5% of respondents who are affected to a very great extent by this challenge are those that sourced funds from Reward platforms (63.2%) and Donation platforms (36.8%). It is worth noting that the reason for this as noted in the (World Bank, 2013) study is that these platforms are by nature typically designed to be funded by the campaign-makers network. These platforms generally operate on a “host” basis acting as an open platform or market place for campaigns.

Figure 4.3 Value of MSMEs Network by Platform Type

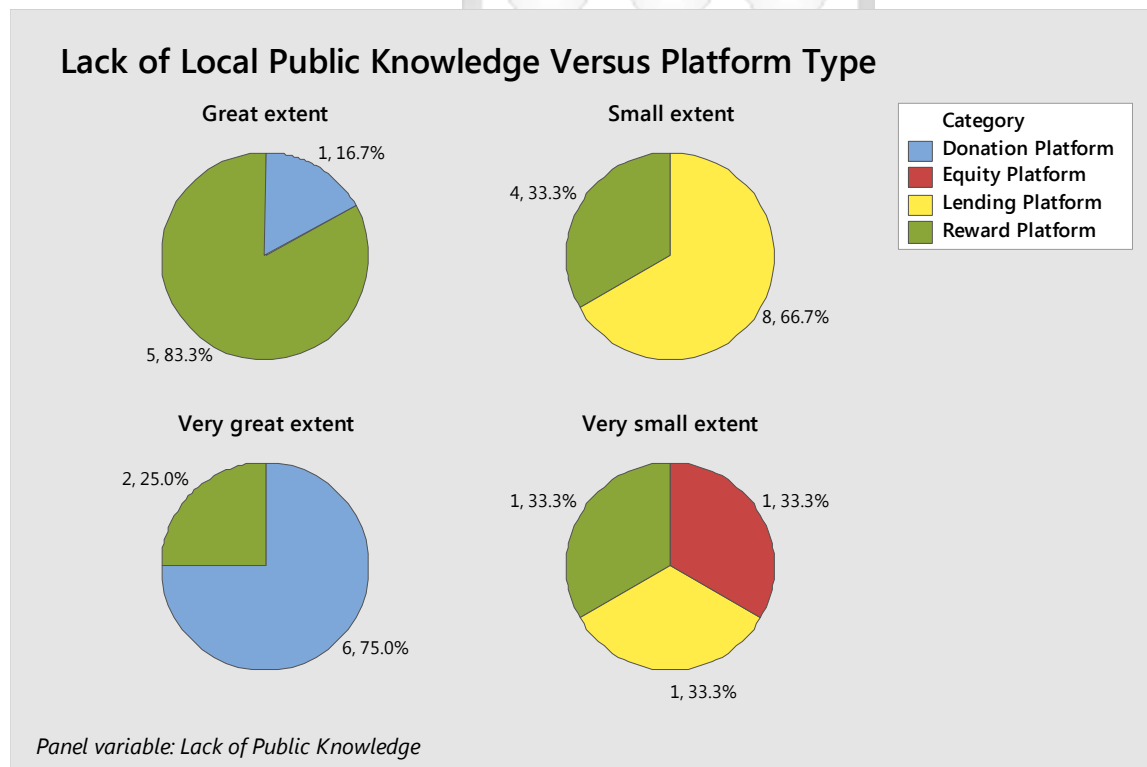


4.4.2 Lack of local public knowledge and acceptance of platforms

The lack of public knowledge and acceptance of platforms is defined by the level of awareness and knowledge of the existence and workings of crowdfunding platforms. **Figure 4.4** shows the level of

public knowledge and acceptance by platform type. Respondents who are affected by this challenge to a “very great extent” (27.6%) and “great extent” (20.7%) by this challenge are those that were sourcing funds from Donation and Reward platforms. These platforms as noted earlier rely on sourcing funds from the MSME networks. One respondent, the owner of Eco-Agribusiness who sourced funds from M-Changa a Donation based platform noted *“Kenyans do not understand the use of crowdfunding to fund business. They have their own personal problems for them to choose to help you in your business”*. Most will appreciate crowd funding when it comes to personal causes such as illnesses, but not for business” He further noted that, if you use Donation or Reward platforms the size and value of your network must include foreigners living in developed markets. It is worth noting that 34.45 % of the respondents had foreign co-owners which made it easier for some to use international Reward and Donation platforms and further access their foreign networks.

Figure 4.4 Public Knowledge and Acceptance of Platforms by Type of Platform

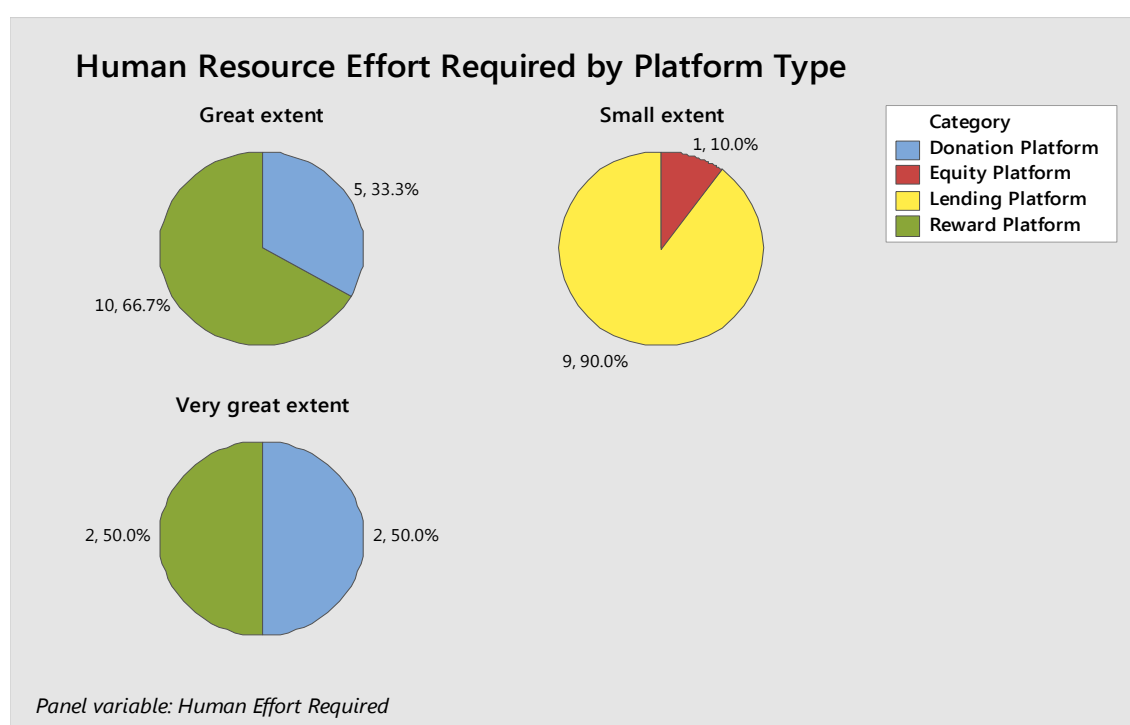


4.4.3 Human effort required

The human effort required is defined by the level of effort required to design and execute a funding campaign. **Figure 4.5** shows that Donation and Reward platforms require human resource effort to a “very great extent” 13.8% and “great extent” 51.7% respectively. This is because this platforms as noted earlier only operate on a “host basis”. This confirms our literature that much effort is required to design a quality campaign, plan and execute the outreach to the MSMEs network. Lending and

equity platforms do not merely act as a host as the platform owners play a role in bringing the crowd to the platform. These platforms have a select crowd of investors that they attract.

Figure 4.5 Human Effort Required

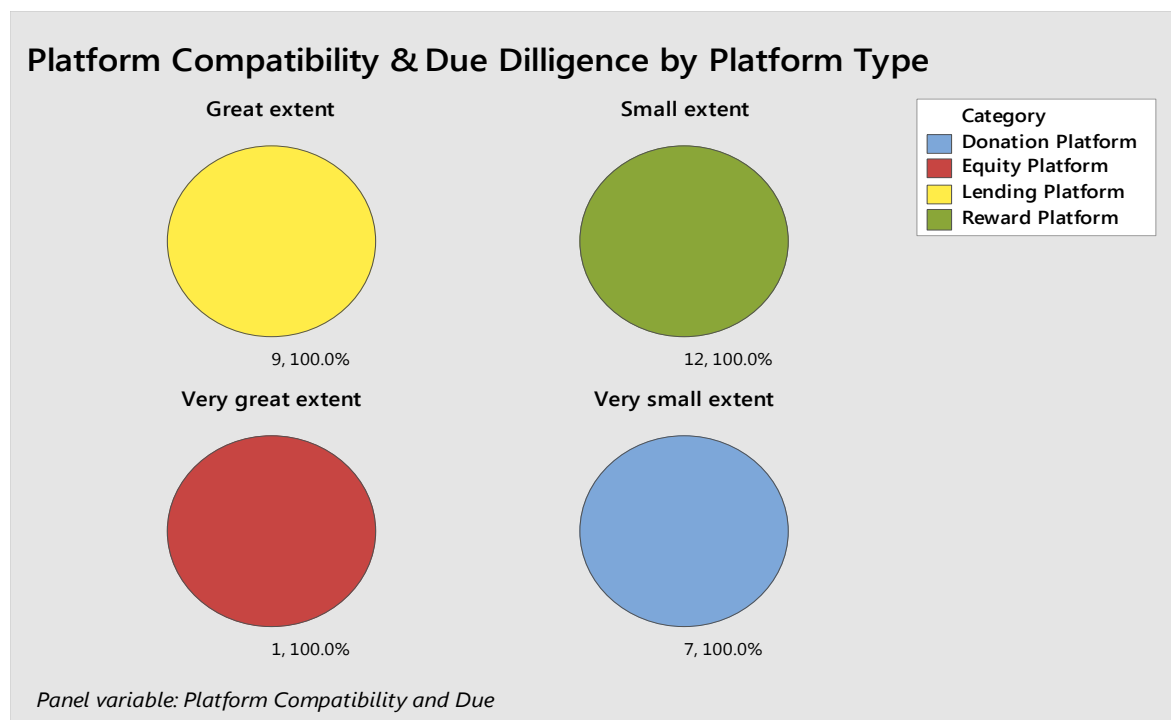


4.4.3 Platform compatibility and due diligence process

The platform compatibility refers to the extent to which a particular platform type is suited to a MSMEs funding need. The due diligence process are the procedures that must be met before allowing an MSME to source funds from a particular platform. The funding need and due diligence fit affects the choice of platform for the MSMEs. According to **Figure 4.6** platform compatibility and due diligence process affects to a “very great extent” (100%) and “great extent” (100%) entrepreneurs’ who used the equity and debt crowdfunding platforms respectively to raise funds for their businesses. This could be primarily because there is rigorous and onerous due diligence process completed by these platforms, which likely weeds out potentially unsuccessful campaigns. This confirms literature (World Bank, 2013) that donation and reward platforms seem to have lower levels of due diligence

because they rely less on the members of these platforms to fund projects but rather campaigns are typically funded by the campaign-makers network.

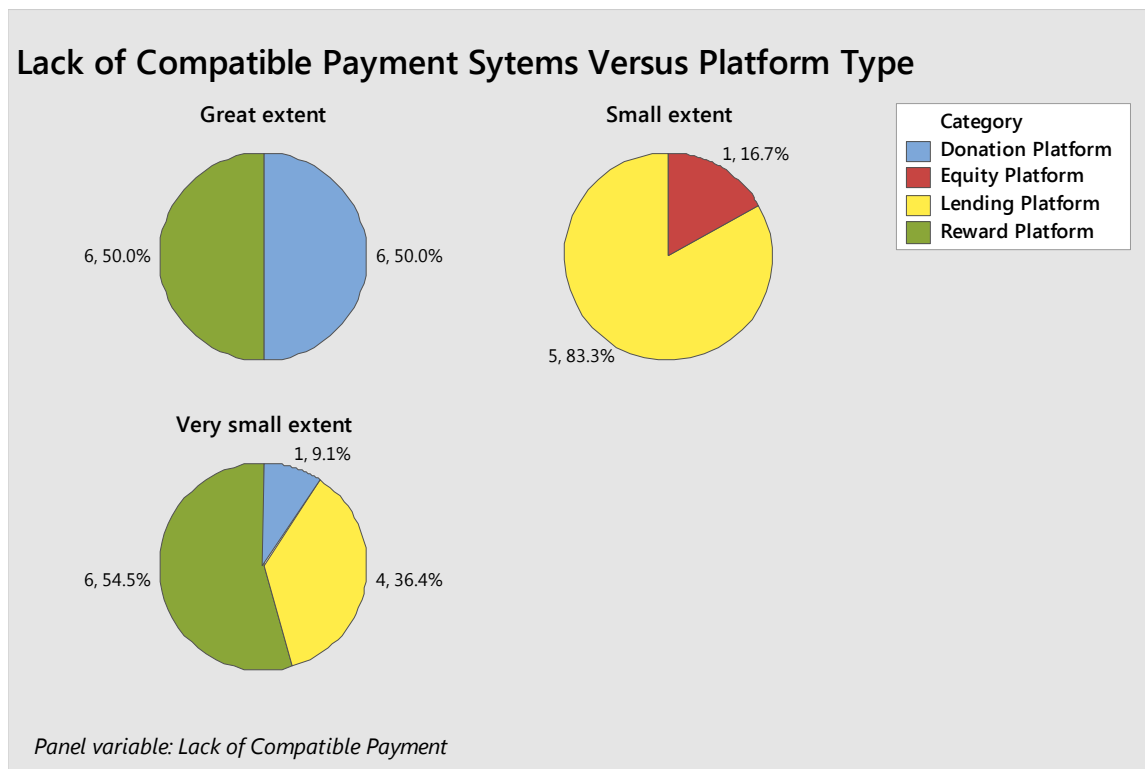
Figure 4.6 Platform Compatibility & Due Diligence Process by Platform Type



4.4.4 Lack of compatible payment systems for international platforms

Payment systems have an influence on the platform choice. The forefront international crowdfunding platforms habitually have limitations on who can launch campaigns. They also put into place payment systems that hinder contributions from the developing world. **Figure 4.7** reveals that 41.4% of those affected by this challenge used the donation and reward platforms to source financing. Further investigation reveals that these are primarily Kenyan entrepreneurs' who used international donation and reward platforms. This is as confirmed in literature (World Bank, 2015) as some of the challenges that affect East African entrepreneurs' when accessing international platforms. However this research further reveals that the entrepreneurs' that used lending platforms do not consider this a challenge because these platforms also attract members and fundraising is not dependent on the value and size of the MSMEs networks.

Figure 4.7 Lack of Compatible Payment Systems by Platform Type



4.5 Effect of Crowdfunding Platforms in Narrowing the Financing Gap for MSMEs

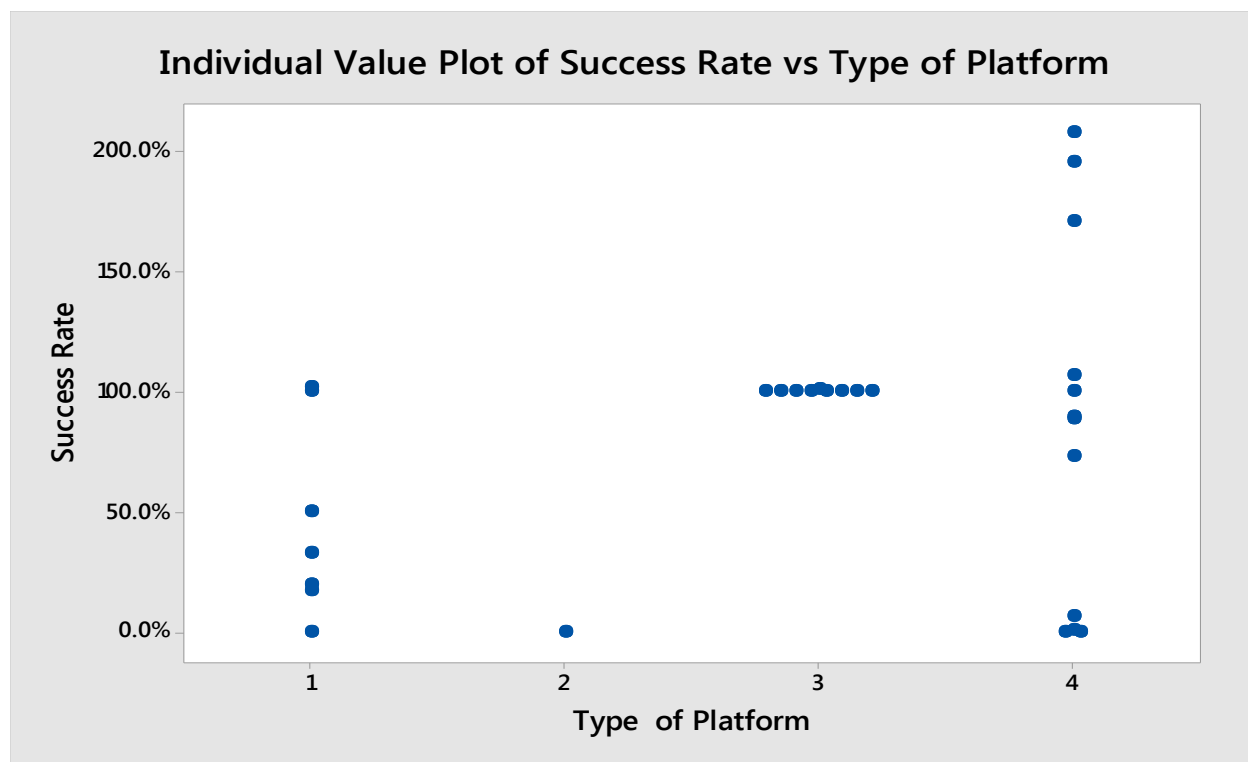
The success rate of a crowdfunding platform campaign is defined by the achievement of the campaign target set by the entrepreneur (Massolutions 2012). The campaign target is assumed to be the “funding gap” for the MSMEs that chose to use crowdfunding platforms to enhance the financing sources for their business. **Table 4.8** shows the success rates achieved by the different types of platforms used by the respondents. From the table, the mean success rate is highest for lending platforms (100%) followed by reward platforms (87%, donation platforms (46%) and finally equity platform (0%). It is important to not however the mean success rates from the reward platform may be skewed by a one off maximum success rate of 208% as shown in **Table 4.8**. This seeks to confirm industry reports that lending platforms have the highest success rates amongst the four platforms (Massolution, 2012).

Table 4.5 Basic statistics of success rates by type of platform

Type of Platform	N	N*	Mean	SE Mean	StDev	Min	Q1	Median	Q3	Max
Donation	7	0	46%	15%	41%	0%	17%	32%	101%	102%
Equity	1	0	0%	0%	0%	0%	0%	0%	0%	0%
Lending	9	0	100%	0%	0%	100%	100%	100%	100%	101%
Reward	12	0	87%	22%	76%	0%	2%	89%	155%	208%

The individual value plot, **Figure 4.8**, of the success rate shows that the lending platform is the most consistent platform with success rates of 100% and above at all times for all the 9 respondents that had used this platform. For the 12 respondents that had used the reward platform, the success rate is varying with three quarters of the respondents below 100%. For the 7 respondents that raised funds through the donation platforms half achieved success rates below the 50%. As noted in the literature review(World Bank, 2015), it important to note that the success rates will largely be influenced by various factors such as funding target or financing gap, value of MSMEs networks(reward & donation) amongst other factors. Since the funding, target is relative, it is important to further analyze the actual amounts of actual funds raised through these platforms.

Figure 4.8 Individual value plot of success rates by type of platform



Where 1- Donation Platform, 2- Equity Platform, 3- Lending Platform, 4- Reward Platform

4.5.1 Level of funds raised through the crowdfunding platforms

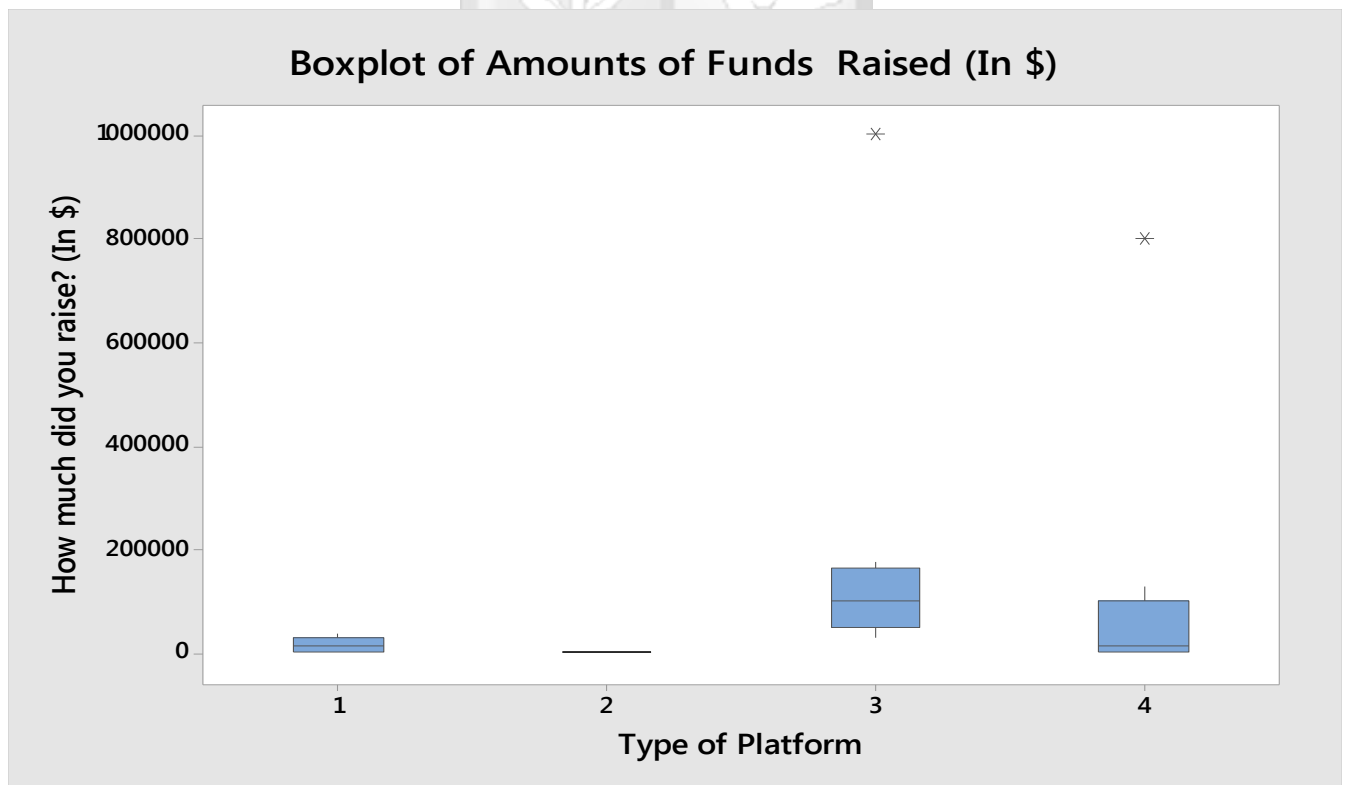
A further analysis of the level of funds raised through the various types of crowdfunding platforms as shown in **Table 4.9** reveals that the donation platform as a mean of USD 14,669, equity platform has a mean of 0, lending platform has a mean of USD194, 664 while reward platform has a mean of USD 93,730.

Table 4.6 Basic statistics of funds raised by type of platform

Type of Platform	N	N *	Mean	SE Mean	StDev	Min	Q1	Median	Q3	Maximum
Donation	7	0	14,669	5,321	14,079	0	422	15,072	30,012	35,738
Equity	1	0	0	0	0	0	0	0	0	0
Lending	9	0	194,664	101,915	305,744	30,000	47,800	100,000	162,500	1,000,000
Reward	12	0	93,730	65,605	227,261	0	971	12,151	99,900	800,000

A further analysis of funds raised by type of platform using a box plot as shown in **Figure 4.9** reveals that there exists the presence of outliers that may skew the average for the respondents who sourced funds through the lending and reward platform. These are respondents who raised amounts of USD 1,000,000 through the debt platform and USD 800,000 the reward platform. The entrepreneur behind Gravity light who raised USD 800,000 through Indiegogo which is a reward platform credits all her success to the value and size of her network. Similarly the entrepreneur behind BBOX which raised USD 1,000,000 through the debt platform Trine credits their success to their revenue performance and achievements’ over the past 3 years.

Figure 4.9 Box Plot of Funds Raised by Type of Platform



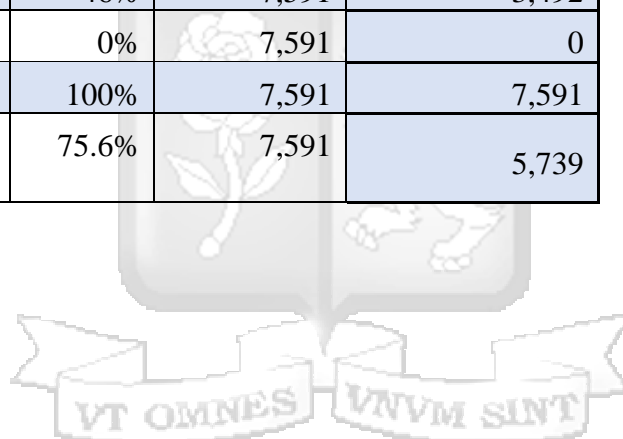
Where 1- Donation Platform, 2- Equity Platform, 3- Lending Platform, 4- Reward Platform

4.5.2 Effect of success rates in narrowing the national funding gap of MSMEs in Kenya

The average financing gap is USD 7,545 per registered but underserved MSMEs. Using the success rates obtained from the crowdfunding platforms, we can extrapolate the effect of different types of crowdfunding platform in narrowing the financing gap for MSMEs in Kenya. For the reward platform, for the purpose of this analysis we have excluded the outlier from one respondent whose success rate was 208% and whose funds raised was USD 800,000. The **Table 4.9** shows the potential effect of the use of crowdfunding platforms in narrowing the financing gap for MSMEs in Kenya. The highest contribution comes from the lending platforms and would be the recommended platform if an entrepreneur is able to pass the due diligence required in order to access fund from these platforms.

Table 4.7 Potential Effect of Crowdfunding Platform

Type of Platform	N	Mean success rates	Average financing gap per MSME	Potential effect of crowdfunding platform
Donation	7	46%	7,591	3,492
Equity	1	0%	7,591	0
Lending	9	100%	7,591	7,591
Reward* (Adjusted)	11*	75.6%	7,591	5,739



CHAPTER FIVE

DISCUSSIONS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The purpose of this study was to analyse the financing gap that exists in MSMEs in Kenya and the effect that crowdfunding platforms provide in enhancing their financing opportunities. The average success rates of four different types of crowdfunding platforms was determined as percentage of amounts raised from the platform versus the target amounts the entrepreneurs' were seeking from these platforms. The average success rate for each platform was then applied to national average financing gap to provide a recommendation on which platform could be an ideal contributor in narrowing the financing gap at the same time keeping in mind the challenges the MSMEs in Kenya face in accessing these platforms.

This chapter presents discussions of findings obtained from data analysis based on the specific objectives of the study, conclusions that can be derived from the findings and recommendations that can be made for future studies.

5.2 Discussions

This section provides discussions based on the findings in line with the study objectives as outlined in section 1.4.

5.2.1 Financing gap for MSMEs in Kenya

From the secondary data obtained from World Bank and Central Bank of Kenya the financing gap was found to be equal to **USD 7.1 billion dollars**. A sanity check of the same number from the World Bank in 2013 reveals a credit gap of 6.1 billion for Kenya. The average gap therefore is USD 7,545 per registered but underserved MSMEs. This gap was arrived at by looking at the supply side estimation of average loan for each type of MSME, the loan access rates and number of each type of MSME. The average loan size was found to approximately KSh590,000 for micro-enterprises, KSh1.9 million for small firms, KSh5.4 million for medium enterprises, and about Ksh41 million for large firms. The level of access to credit was found to be 6% for micro-enterprises, 20.2% for small enterprises and 23.4 % for medium enterprises. The number of registered micro, medium and small enterprises was found to be 890,000, 120,000 and 10,000 respectively.

5.2.2 Challenges faced by MSMEs in sourcing funds through crowdfunding platforms

The key main challenges facing the Kenyan MSMEs sourcing funds from crowdfunding platforms include firstly value and size of MSME networks and size of MSMEs network. 65.5% of respondents who are affected to a very great extent by this challenge are those that sourced funds from reward platforms (63.2%) and donation platforms (36.8%). It is worth noting that the reason for this is that

these platforms are by nature typically designed to be funded by the campaign-makers network. Secondly, there is lack of public knowledge and acceptance of platforms. Respondents who are affected by this challenge to a “very great extent” (27.6%) and “great extent” (20.7%) by this challenge are those that were sourcing funds from Donation and Reward platforms. These platforms as noted earlier rely on sourcing funds from the MSME networks. Thirdly, the human effort required to access funds from some of the platforms is also a key challenge. The donation and reward platforms require human resource effort to a “very great extent” 13.8% and “great extent” 51.7% respectively. This is because this platforms as noted earlier only operate on a “host basis”. Thus much effort is required to design a quality campaign, plan and execute the outreach to the MSMEs network. Fourthly platform compatibility and due diligence process can be a barrier particularly when accessing the lending platforms. This could be primarily because there is rigorous and onerous due diligence process completed by these platforms, which likely weeds out potentially unsuccessful campaigns. Lastly those affected by lack of compatible payment systems for international platforms used the donation and reward platforms to source financing. Further investigation reveals that these are primarily Kenyan entrepreneurs’ who used international donation and reward platforms

5.2.3 Effect of crowdfunding platforms in narrowing the financing gap for MSMEs

The success rate of a crowdfunding platform campaign is defined by the achievement of the campaign target set by the entrepreneur. The campaign target is assumed to be the “funding gap” for the MSMEs that chose to use crowdfunding platforms to enhance the financing sources for their business. The mean success rate is highest for lending platforms (100%) followed by reward platforms (87%, donation platforms (46%) and finally equity platform (0%).

From the researchers deductions and calculations the average financing gap is USD 7,545 per registered but underserved MSMEs. Using the success rates obtained from the crowdfunding platforms, we can extrapolate the effect of different types of crowdfunding platform in narrowing the financing gap for MSMEs in Kenya. The highest contribution comes to the national average financing gap comes from the lending platforms and is the recommended platform if an entrepreneur is able to pass the due diligence required in order to access fund from these platforms. The key barrier for success on the donation and reward platforms may largely be affected by the size and value of an MSME network and this will vary from one MSME to another.

5.3 Conclusion

The study findings reveal that the mean success rate is highest for lending platforms (100%) followed by reward platforms (87%), donation platforms (46%) and finally equity platform (0%). From the secondary data the average financing gap is USD 7,545 per registered but underserved MSMEs. The highest contribution to the national average financing gap evidently comes from the lending platforms. There are various challenges faced by MSMEs in accessing funding such as the value and size of MSMEs network, human effort required, compatible payment systems and the due diligence process required. The extent to which these challenges are faced largely depend on the platform type. For example, the value and size of MSME networks largely affects those sourcing funds from the donation and reward platforms. Extensive due diligence processes affect to a very great extent those sourcing funds from the lending platforms. The level of public knowledge and acceptance towards the use of the crowdfunding platforms is still a barrier particularly for those trying to source funds through the reward and donation platforms. The reward and donation platforms have an easy due diligence process and can be accessed by literally almost any MSME. The study findings reveal that crowdfunding platforms can enhance the financing opportunities for the MSMEs and could provide the much needed solution to narrowing their financing gap.

5.4 Recommendations

The highest contribution to the national average financing gap evidently came from the lending platforms and is the recommended platform as long as an entrepreneur is able to pass the due diligence processes required in order to access funds from these platforms. MSMEs that can pass the due diligence processes should be made aware and encouraged to explore the use of the lending platforms as an option.

Moreover, the use of crowdfunding platforms by registered MSMEs remains largely untapped with only 30 MSMEs accessing these platforms. This study therefore recommends that there is need for more awareness campaigns to expound on the alternative crowdfunding platforms could provide to MSMEs looking to reduce their financing gaps. As such NGOs, Government, Academic institution can forge strategic partnerships with other stakeholders such as NGOs and academic institutions to increase this awareness. The awareness could target the myths and public knowledge and acceptance of the easily accessible donation and reward platforms in a bid to improve the quality and quantity of contributions to fundraising campaigns. This will see the emergence of a number of locally owned crowdfunding platforms and competition in this space.

5.5 Suggestions for Further Study

The importance of MSMEs is one that cannot be overlooked. In the arena of academia, scholars can contribute towards this end by undertaking more studies to fill the knowledge gap particularly on the size financing gap facing MSMEs in Kenya. Further studies are also required on the due diligence processes the MSMEs face in accessing the various types of platforms. Through public awareness, it is expected that the number of Kenyan MSMEs accessing these platforms would increase. Further studies will then need to be conducted to further assess the success rates sourcing funds through these platforms through a wider population as more and more MSMEs access these platforms in the near future.



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APPENDIX 1

KENYAN MSMEs WHO HAVE ACCESSED CROWDFUNDING PLATFORMS

This Appendix shows the 48 crowdfunding platforms accessible to Kenyans and the 30 Kenyan based MSMEs who have accessed these platforms.

Platform	Capital Type	Number of Kenyan Based SMEs that have accessed	Names of MSMEs	Kenyan Social and Personal Causes Supported	Comments
4just1.com	Donation	0	N/A	7	
Awesome Foundation	Donation	0	N/A	0	
Afrikstart	Donation	0	N/A	0	Not yet gone live
Better Place	Donation	0	N/A	0	
Buck4Good	Donation	0	N/A	0	
Change Heroes	Donation	0	N/A	0	They partner with not for profits and foundations to fund social causes
Fundly	Donation	0	N/A	668	
Give Forward	Donation	0	N/A	84	
GivenGain	Donation	0	N/A	75	
Givology	Donation	0	N/A	93	
GlobalGiving	Donation	0	N/A	160	
Generosity	Reward	1	Sunny Irrigation	0	
GoFundMe	Donation	0	N/A	130 Individual Entrepreneurs(not companies)	
Hubbub	Donation	0	N/A	11	

Platform	Capital Type	Number of Kenyan Based SMEs that have accessed	Names of MSMEs	Kenyan Social and Personal Causes Supported	Comments
JustGiving	Donation	0	N/A	82	
Kangu	Donation	0	N/A	10	
Kopernik	Donation	0	N/A	7	
M-Changa	Donation	8	Sunny money, Green char,Eco-Agribusiness, Kenya Green Supply, Ukulima Tech, Chaff Energy, Kasigau Tree Firm, Kencoco	1190	
OnePercentClub	Donation	0	N/A	177	
PifWorld	Donation	0	N/A		
Ammado	Donation	0	N/A	289	
Common Sites	Donation	0	N/A	0	
Watsi	Donation(Patient support)	0	N/A	0	
IndieVoic.es	Donation/Reward	0	N/A	200	
Indiegogo	Donation/Reward	5	Lumen, Wanda Organics, Skynotch, Sanivation, Gravity Light		
Kickstarter	Donation/Reward	2	Enda, Bora Wear,	137	
KissKissBank Bank	Donation/Reward	0	N/A	4	
Crowdcube	Equity	1	Prex construction and interior design	536	
Chuffed	Equity/Donation	0	N/A	57	Site not operational
Bit Bond	Lending	0	N/A	0	No Kenyans have accessed yet

Platform	Capital Type	Number of Kenyan Based SMEs that have accessed	Names of MSMEs	Kenyan Social and Personal Causes Supported	Comments
BTC Jam	Lending	0	N/A	0	No Kenyans have accessed yet
Lendahand	Lending	4	Pwani Feeds Limited, Sim Gas Kenya Limited, Logistics Link Limited, Chriven Enterprise,	2	
PesaZetu	Lending	0	N/A	0	Person to person lending. Lending to individuals not registered businesses
Razoo	Lending	0	N/A	281	
SeedGrants	Lending	0	N/A	1	
Solvesting	Lending	0	N/A	0	Not yet gone live
Kiva	Lending	0	N/A	571(Micro loans to individuals, Not registered enterprises	
Trine	Lending	5	Mibawa Supplies Limited, RVE SOL, Intasave, BBOX, Pawame,	0	
Yewou	Lending/Equity	0	N/A	0	Not yet gone live

Platform	Capital Type	Number of Kenyan Based SMEs that have accessed	Names of MSMEs	Kenyan Social and Personal Causes Supported	Comments
Crowdfunder	Reward	2	Faida Forex Prex , Brad Supplies and Logistics	70	
Freudon	Reward	1	Afroelle Magazine	0	
GridShare	Reward	0	N/A	0	
RocketHub	Reward	0	N/A	0	
StartSome Good	Reward	0	N/A	134	
Ulule	Reward	0	None	2	
Bid Network		0	N/A	0	Makes SMEs investor ready
Patreon		0	N/A	0	Individual fashion creators not business nor entrepreneurs
BetterVest	Reward	1	Borreal Light -Kenya		
Total		30			

APPENDIX 2

QUESTIONNAIRE FOR MSMEs

I am Linda Onyango, a post graduate student at the Strathmore Business School. I am undertaking a study titled:

“An Analysis of the Effect of Crowdfunding Platforms in Enhancing the Financing Sources for Micro Small and Medium Enterprises (MSMEs) in Kenya.”

The study is meant for academic purposes. The information provided in the interviews will remain strictly confidential and anonymous. The information will be used only for the purposes of this study whose findings will be used to assist me meet the requirements of a degree in Masters of Business Administration. Please be honest and truthful with your responses

Your cooperation is highly appreciated

Section A: Demographic Information

1. Position held in the business
 - a) Owner
 - b) Employee
2. The type of business
 - a) Technology business
 - b) Retail business
 - c) Manufacturing
 - d) Agri-business
 - e) Renewable energy
 - f) Others, Please specify
3. How long has the business been in operation?
 - a) Less than a year
 - b) 1 – 5 years
 - c) 6 -10 years
 - d) Above 10 years
4. Number of employees in the business
1-9 10-20 21-30 31-50 51- 99
5. What is the size of the business in terms of sales/revenues per year? (Amounts are in USD)

- a) < 5,000
 - b) 5,000 – 9,999
 - c) 10,000 – 29,999
 - d) 30,000 – 49,999
 - e) 50,000 – 99,999
 - f) 100,000 – 999,999
 - g) 1,000,000 to 1,999,999
 - h) 2,000,000 to 8,000,000
6. What was the stage of your business at the time of considering crowdfunding platforms?
- a) Ideation (Just an Idea)
 - b) Pilot (Testing the Idea)
 - c) Validation(Early stages before profit breakeven)
 - d) Growth(Break even and profit making stage)
 - e) Scale(Expansion new products, new regions)

Section B: Effect of Crowdfunding Platforms in Narrowing the MSMEs Financing Gap

7. Did you get financing from other sources before considering the crowdfunding platforms? (Tick all that apply)
- a. No
 - b. Yes- personal finances
 - c. Yes - a bank loan
 - d. Yes- grant
 - e. Yes - venture capital (equity)
 - f. Yes – friends& family
8. Which of the following crowdfunding platforms did you use?
- a) Equity based
 - b) Donation based
 - c) Lending based
 - d) Reward based
9. What was / is your campaign's funding target amount? (In \$).....
10. How much did you raise? (In \$).....

Section C: Challenges Faced by MSMEs in Sourcing Funds through Crowdfunding Platforms

11. Would you advise other Kenyan business owners to access funding through crowdfunding platforms to increase their capital or cash flow?

- a) Yes
- b) No
- c) Maybe

12. We have outlined the KEY CHALLENGES facing East African entrepreneurs’ when sourcing funds through crowdfunding platforms as a Kenyan MSME please rate the extent to which you agree or disagree with each of these challenges. (You can tick more than one reason).

Challenges	Not All	at Very Small Extent	Small Extent	Great Extent	Very Great Extent
Lack of public knowledge and acceptance of Crowdfunding platforms					
Value and size of MSMEs network					
Human effort required					
Lack of compatible payment systems to international platforms					
Platform compatibility and due diligence process					

13. Please provide your general comments on your experience in using the type of crowdfunding platform that you used. What is your general comment around the above challenges with regards to the platform type that you used.

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