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**FACTORS CONTRIBUTING TO BORROWER
DISCOURAGEMENT AMONG MICRO, SMALL AND MEDIUM
ENTERPRISES IN NAIROBI COUNTY, KENYA**



MARY GAKII KITHURE

(31065)

**A THESIS SUBMITTED IN PARTIAL FULFILMENT OF THE
REQUIREMENTS OF MASTER OF SCIENCE IN DEVELOPMENT
FINANCE OF STRATHMORE UNIVERSITY BUSINESS SCHOOL**

MAY 2024

DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the dissertation itself.

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Mary Gakii Kithure
(31065)

Signature:  **Date:** 30-5-2024

APPROVAL

This thesis for Mary Gakii was appraised and signed off for examination by the following:

 **Date:** 30-5-2024

Dr. Patricia Gachambi Mwangi
Strathmore Business School

ABSTRACT

The banking sector has made tremendous efforts towards providing opportunities for business enterprises to increase financial access which has been a major impediment to their growth and sustainability. Despite these efforts, small business remains financially constrained but at the same time are hesitant in applying for bank credit. This latent demand is viewed as borrower discouragement and potentially affects the ability of micro small and medium enterprises to attain their full potential in Kenya. This research examined the factors contributing to borrower discouragement among micro small and medium enterprises in Nairobi County. The study was guided by three specific objectives to: determine entrepreneur characteristics, firm level characteristics, and business environment influence on borrower discouragement among micro small and medium enterprises. The study was based on general systems theory, resource-based view, institutional theory, and deterrence theory. A positivist research philosophy was adopted under which a descriptive cross sectional research design was implemented. The target population was 12,492 enterprises in Nairobi County. Stratified simple random sampling was used to select 205 respondents. Data was collected through administration of questionnaire. Descriptive and inferential statistical analysis was done. Results of the study depicted that entrepreneur characteristics, firm level characteristics, business environment characteristics had a positive statistically significant effect on borrower discouragement. Policy recommendation is that targeted training programmes be designed for MSMEs, and undertaken regularly focusing on loan application procedures, requirements and proper use of funds. This will close gaps on product knowledge and address borrower apprehension.

Key words: Entrepreneur characteristics, firm level characteristics, business environment characteristics, borrower discouragement.

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DEDICATION

I would like to take this opportunity to thank the almighty God from whom all good things come, for giving me the courage and grace to attend this program at this stage in my life.

I want to dedicate this work to my parents Mr Stanley Kithure and Mrs Violet Mukiri Kithure who have always believed in the power of learning.



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DEFINITION OF TERMS

Borrower Discouragement	This refers to the reluctance of an entrepreneur to seek debt financing/loans due to their past negative experiences and/or perceptions.
Business Environment	These are direct or indirect external elements that have a bearing on the activities of an enterprise such as tax policy, inflation, and corruption. They are the business environment factors considered in this research.
Entrepreneurial Characteristics	These refer to the personal characteristics of an entrepreneur and in this study are limited to the entrepreneur's education, experience and gender
Firm-level Factors	These refer to the features of an enterprise such as the age, size and ownership structure of a business.



LIST OF ABBREVIATIONS

BETA	Bottom-Up Economic Transformational Agenda
CBK	Central Bank of Kenya
CEOs	Chief Executive Officers
CRB	Credit Reference Bureau
EC	European Commission
ECB	European Central Bank
ESI	Economic Sentiment Indicator
EU	European Union
GDP	Gross Domestic Product
GST	General Systems Theory
HELB	Higher Education Loans Board
ICEG	International Center for Economic Growth
KNBS	Kenya National Bureau of Statistics
LSBS	Longitudinal Small Business Survey
MSEA	Micro and Small Enterprise Authority
MSMEs	Micro, Small and medium enterprises
NACOSTI	National Commission for Science, Technology and Innovation
RBV	Resource-Based View
SAFE	Survey on the access to finance of SMEs
SU-ERB	Strathmore University Ethical Review Board (SU-ERB)
UK	United Kingdom
US	United States
VIF	Variance Inflation Factors
VRIN	Valuable, Rare, Inimitable, and Non-Substitutable
WBES	World Bank's Enterprise Survey

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Micro, Small and medium enterprises (MSMEs) play a major role in employment and gross domestic product (GDP) around the world. In developed economies such as the United States (U.S.), MSMEs contribute 44% of the total economic activity and create 62% of all new jobs (Cavalluzzo & Wolken, 2015). In Europe, contributions from SMEs account for 99% of all non-financial enterprises, contributing 66.6% of all jobs and generating 56.4% of total value added to the economy. These SMEs employ 5 workers on average, generate half of business sector GDP and provide half of all business sector employment (Calabrese, Girardone, & Scip, 2020). In China, SMEs employ 79% of the working population and contribute 60% of GDP and 68% of exports (Caglayan, Talavera, Xiong, & Zhang, 2022).

MSMEs in South Africa have contributed to employment of 47% of its working population while generating 20% of the GDP and 6% of total corporate taxes (Khoza, Adeniyi, & Ayandibu, 2022). In Nigeria MSMEs contribute 50% of GDP and account for 80% of jobs created (Chinedu & Chinedu, 2018). MSMEs in Kenya comprise of 80-85% of all enterprises and businesses and account for more than 30% of the jobs created annually (Kenya National Bureau of Statistics [KNBS], 2016). Despite their importance, MSMEs face various obstacles that limit their potential as mechanisms of transformation in the economy.

Empirical studies show that investment climate factors such as the legal process, availability of formal credit, provision of utilities and lesser crime affect MSME growth (Shibia & Barako, 2017). Of all these, finance is the most robust of them all and shortage of funds was given as a reason for closure of 29.6% of MSMEs (KNBS, 2016). MSMEs largely depend on bank credit and internal cash flows despite the growth of other forms of co-financing such as crowd funding, venture capital and angel financing (Lee & Brown, 2017). They have limited entry into capital markets because their financial structures are meagre and their public/ financial information non-existent (World Bank, 2017).

Market access on the supply side, has challenges which have genesis in the lack of track records and information opacity. Financiers require evidence of repayment ability that is drawn from cash flows of the enterprise to sanction debt. SMEs however do not maintain detailed accounts as compared to large firms, and an information gap arises that leads to uncertainty as opposed to risk (Fraser 2019). Cash flows generated are unobservable and can only be verified through audits whose cost cannot be justified by the small amounts needed (Fraser 2019).

Information asymmetry therefore constraints market efficiency in SME lending and is well discussed in literature (Beck & Demirguc-Kunt 2006). Imperfect information means lenders are unable to determine the quality of borrowers hence loan terms and conditions used affect behavior (Atieno 2001). Lenders may set the price of credit above optimal levels or rationalize credit (Hoff & Stiglitz 1990). The interest rates charged play a dual role of influencing prospective borrowers (adverse selection) or modifying the deeds of the borrower (incentive effect). To control for moral hazard on part of the entrepreneur, lenders request extensive collateral and increase transactional costs through screening and monitoring (Beck & Demirguc-Kunt 2006). The funding gap arises in the barrier set between the cost of in-house and commercial funds (Kaplan & Zingales 1997). Firms are therefore unable to raise the necessary amounts to fulfill their investment and growth goals.

On the demand side, creditworthy SMEs may opt not to apply for debt finance despite having credit needs and positive net present value projects. These are discouraged borrowers defined by Kon and Storey (2003) as applicants who fear their application will be rejected given their profile. The entrepreneur's cognition affects the perception of funding options available and the perceived ability to exploit them (Fraser 2019). These firms refrain from bank loan application because they anticipate rejection or tough lending conditions (Mol-Gómez-Vázquez et al., 2018).

The phenomenon of borrower discouragement among MSMEs is not unique to any nation but is present around the world and there exists significant variations in borrower discouragement across nations. Scholars show varying figures; according to Statnik and Vu (2020), the pervasiveness of discouragement in the developed and emerging economies stands at 16.4% against 28.5% respectively, according to Qi and Nguyen

(2021), it occurs between 1% and 45% in emerging markets as compared to between 10 and 20% in developed ones. Calabrese et al. (2020) established there are at least 6.5% of MSMEs in some regions of European Union (EU) that are discouraged borrowers.

1.1.1 Factors Influencing Borrower Discouragement

There is evidence to indicate that borrower discouragement is as a product of diverse factors that include personal characteristics of the entrepreneur (Naegels et al., 2021; Galli et al., 2018; Nguyen et al., 2020). MSMEs are solely governed by the owner and in most cases the owner also serves as the manager, resulting in little separation between ownership and control (Ang, Cole & Lawson 2010). The age, gender and education of the individual consequently have an effect on the financing decisions of the enterprise. Studies such as Naegels et al. (2021) have demonstrated that negativity causes an apprehensive view of bank loans and together with one's interpretation of societal norms may result in low motivation to apply. Galli et al. (2018) results also highlighted that the probability of self-rationing in women-led SMEs was higher vis-à-vis their male counterparts.

The firms profile influences its financial needs and its ability to fulfill the lenders requirements. Factors such as age and size are important because older, larger firms are more likely to have more retained earnings as compared to newer smaller ones (Mac an Bhaired & Lucey 2010). Past positive experiences in borrowing influence the intention to borrow and established firms are more recognised and hence enjoy ease in borrowing. The influence of firm characteristics therefore plays a role in determining discouragement and have been tested in different studies. Nguyen et al. (2020) research results revealed that enterprises that were younger, smaller, and had wider business networks were more likely to belong to discouraged borrowers. Other researchers such as Wernli and Dietrich (2022) showed that the relationship that the firm has with banks can lead to discouragement; including the number of relationships with banks and relationship with a government-owned bank. Xiang, Worthington, and Higgs (2015) established that past experiences of being discouraged contributed to future loan seeking behavior.

In Cote D'Ivoire, Ghimire and Abo (2013) presented evidence to show borrower discouragement was more prevalent in Micro Enterprises (MEs) compared to Small and Medium Enterprises (SMEs). Cowling and Sclip (2022) found that firm-level risk factors were influential in explaining borrower discouragement. Rahman et al. (2017) empirical results suggested that interest rates had negative outcomes on access to finance for MSMEs and therefore contributed to borrower discouragement.

Organizations operate in an environment that is impacted by macroeconomic circumstances driven by economic growth, inflationary forces, interest fluctuations and exchange rates. These factors may promote or inhibit MSMEs and this has been of interest to researchers. Bhaird, Lucey, and Vidal (2016) concluded that poor macroeconomic conditions limit the amount to lend and this, together with increased interest rates had an effect on SME discouragement. Cowling and Sclip (2022) results suggested that chances for transitioning from non-discouragement to discouragement were driven by macro-specific factors. Ferrando and Mulier (2022) research found that firms showed more discouragement after an increase in interest rates charged by banks while higher tax rates contributed to lower discouragement in line with the trade-off theory. Galli et al. (2018) results highlighted that corruption did contribute to borrower discouragement.

According to Anastasiou, Kallandrains, and Drakos (2022), some entrepreneurs evaluate the likelihood of receiving loans from the performance of the economy. Factors such as inflation and taxation are used to judge the credit-worthiness of their enterprise and probability to receive a loan. The state of being optimistic or pessimistic on the economy affects availability of credit and the overall economic activity. There is proof from literature that there exists a positive interaction between leverage and economic expectation (Rostamkaleai, 2017). Out of this review, factors contributing to borrower discouragement were grouped into entrepreneur, firm-level characteristics, and business environment (Anastasiou et al., 2022; Cowling & Sclip, 2022; Ferrando & Mulier, 2022).

1.1.2 Borrower Discouragement

Caglayan et al. (2022) defined a discouraged borrower as a person who stops participating in loan application based on their negative experiences with the process. It is a definition based on observed behavior and thus differs from the survey-based definition that describes them as those choosing not to apply for a new loan due to anticipated rejection. Žak (2018) explains that some firms do not seek financing, even if they need it, notwithstanding their favourable growth prospects and sound economic situation. This attitude, defined as reluctance to apply for credit is known as “borrower discouragement.

Out of this distinction, this study is based on the concept of borrower discouragement that is a dynamic concept which has been measured using different indicators in the increasing attention it is receiving from research in SMEs (Brown et al., 2022). One of the most widely used proxies has been using a binary variable where an enterprises’ discouragement equals to one (1) when there is no loan application and is zero (0) if the firm applies for the loan (Chakravarty & Xiang, 2013; Brown et al., 2022; Osei-Tutu & Laurent Weill, 2023). Using a different approach, Wernli and Dietrich (2022) classified discouraged borrower firms into “no need”, “discouraged”, “approved”, and “denied” based on their experiences in the past 12 months.

In their research, Mol-Gómez-Vázquez et al. (2022) measured borrower discouragement from asking respondents if they had applied for a loan or not, with yes responses being coded one and no being coded as zero. Therefore, to measure incidence of borrower discouragement, respondents were asked if they needed a loan and their response from this question was followed by answering the question if they applied for a loan. This method has been used in the past (Chakravarty & Xiang, 2013; Brown et al., 2022; Osei-Tutu & Laurent Weill, 2023) to measure prevalence of borrower discouragement. Additionally, a five-point Likert scale was used to measure perceptions associated with borrower discouragement.

1.1.3 Micro and Small Medium Enterprises in Nairobi County

Micro, small, and medium-sized enterprises (MSMEs) promote high economic activity in Kenya and account for more than 98% of all business (KNBS 2022). Historically, the Kenya government has prioritized the MSMEs sector through various policy undertakings. The sessional paper 1 (1986) on Economic Management for renewed growth explicitly acknowledged the contribution MSMEs make in the economy through employment creation and income generation. The policy however did not provide a comprehensive policy to approach the sector. Sessional Paper 2 on Development of Micro and Small Enterprises for Wealth and Employment Creation 2005, sought to create institutional support for the sector and resulted in the enactment of the 2012 Micro and Small Enterprises (MSE) Act (Micro and Small Enterprise Authority [MSEA], 2021).

MSMEs play a critical role in the Bottom-Up Economic Transformational Agenda (BETA) and the MSEA is mandated to facilitate, coordinate, and execute integration of different private and public programs aimed at the regulation, development, and promotion of MSMEs. Under the Act, MSMEs are defined by employment size and turnover. Microenterprises are those that generate below Kshs. 500,000 annually and employ less than 10 persons. Small firms have an annual turnover of between Kshs. 500,000 and 5 million, employing 10 and 50 employees. Medium enterprises are on the upper end and employ between 50 and 99 employees with a turnover of over Kshs. 5 million annually (KNBS, 2016).

There remains a dearth of information on the status of MSEs in Kenya with the most comprehensive surveys being the 1999 National MSE Baseline Survey (Central Bureau of Statistics CBS, International Center for Economic Growth [ICEG], & K-Rep Holdings Ltd, 1999). This survey was followed by the 2016 MSME nationwide survey (KNBS, 2016). However, these surveys do not provide the recent statistics on status of MSMEs; therefore, this research will use information from the 2023 MSE Tracker Survey to determine its sample size (CBK, KNBS, & Financial Sector Deepening Trust [FSD], 2023). The survey revealed that out of the 1,961 MSEs, 539 had closed while 1,422 were still in operation with 57.6 % of business in operation were female-owned while 42.4 % were male-owned. The MSEs expecting better performance of their

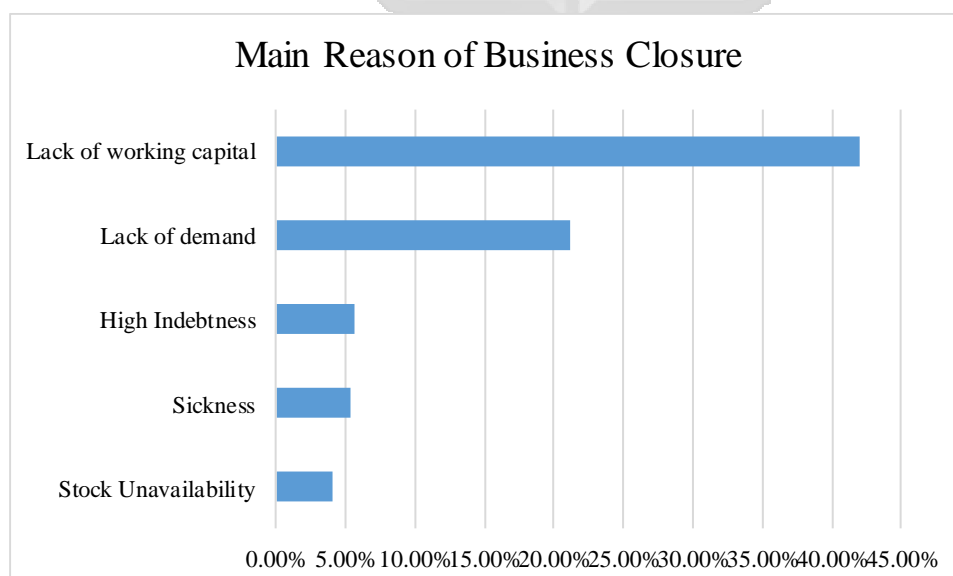
business in the following year declined from those in the previous year while the size of businesses that expected their performance to decline or remain the same increased from the previous year. Overall, the optimism level of business performance reduced while pessimism in the business performance had a slight increase (CBK, KNBS, & FSD, 2023). The proportion of the MSME loans by value to the total banking sector loan portfolio moved from 143.9 billion Kshs in 2017 to 638.3 billion Kshs in 2020 to 783.3 billion Kshs in 2022. This means the MSME loans by value to total banking sector loan portfolio had marginal increases from 19.2 % in 2017 to 20.9 % in 2020 and stood at 21.3 % in 2022 as shown in Table 1.1

Table 1.1: MSME Loan Accounts 2017 – 2023

2017		2020		2022	
Amount	%	Amount	%	Amount	%
413.9 billion	19.2	638.3 billion	20.9	783.3 billion	21.3

Source: Central Bank of Kenya (2023).

The MSME tracker survey (2023) further documented that 42% of businesses that closed did so due to lack of funds for working capital revealing financial constraints among enterprises.



Source: (CBK, KNBS, & FSD, 2023)

1.2 Statement of the problem

There is general concurrence that the startup and progression of small firms is directly associated with their ability to obtain financial resources. Despite this; there is evidence indicating that MSMEs are reluctant to borrow business loans as expected from bank sources. Mulindi et al. (2022) showed that, 41.7 % MSMEs borrowed a business loan while 44.4 % borrowed a personal loan from commercial banks and 13.9 % borrowed from non-bank sources. The aggregate banking sector data from 2020 to 2022 shows a marginal increase by value of MSME loans to the total loan portfolio from 20.9% in December 2020 to 21.3 % in 2022 (CBK, 2023). Similarly, the proportion of MSME loan accounts to the overall banking sector numbers remained constant at 8.0 % from 2020 to 2022 (CBK, 2023). MSME tracker survey (2023) shows lack of working capital as a key reason for business closure. There is low uptake of commercial financing and financial constraints are still being experienced by MSMEs. It is therefore, essential to identify the demand side factors such as borrower discouragement that may be a deterrent to loan application.

In their role, banks have continuously supported MSMEs by providing knowledgeable and accessible relationship managers so as to deliver expert advice on insurance, financial management, investments, and other financial solutions (CBK, 2022). Additionally, they have designed competitive products and reduced interest rates hence increasing borrowing power (Gakii et al., 2022). This study therefore aims to identify what factors induce self-selection or pre-screening among MSMEs and cause non-borrowing from commercial banks. There has been interest from past researchers on factors contributing to borrower discouragement. Yet, majority of these studies (Galli et al., 2018; Wernli & Dietrich, 2022) have used secondary data to analyze relationships between variables. Those in the emerging economies context were limited to female-led MSMEs and adopted a qualitative research method (Ghimire & Abo, 2013; Naegels et al., 2021). Methodological gaps associated with the choice of modelling approach are also evident, with ordinary least squares adoption even on those variables in discrete scale. Further, there are contextual issues that may be attributed to data availability and accessibility in developing countries. The current study therefore was to examine factors that affect borrower discouragement among MSMEs in Nairobi County.

1.3 Research Objectives

1.3.1 General objective

This study examined factors contributing to borrower discouragement among micro, small and medium enterprises in Nairobi County, Kenya.

1.3.2 Specific objectives

The study was guided by these specific objectives:

- i. To determine the influence of entrepreneur characteristics on borrower discouragement among MSMEs in Nairobi County
- ii. To determine how firm level characteristics influence borrower discouragement among MSMEs in Nairobi County
- iii. To determine the influence of the business environment on borrower discouragement among MSMEs in Nairobi County

1.4 Research Questions

The study answered these questions:

- i. How do entrepreneur characteristics influence borrower discouragement among MSMEs in Nairobi County?
- ii. How do firm-level characteristics influence borrower discouragement among MSMEs in Nairobi County?
- iii. How does the business environment influence borrower discouragement among MSMEs in Nairobi County?

1.5 Scope of the Study

The reach of MSMEs is in the 47 Counties; however, the research was limited to Nairobi County and therefore focused on the county as it has a high proliferation of opportunities for MSMEs in diverse sectors and industries to acquire loans and finance. The study limited its conceptual scope to entrepreneurial characteristics, firm-level characteristics, and business environment factors as its independent variables. Borrower discouragement was its dependent variable. Due to the relatively large sample size, the study adopted a quantitative approach under the positivist research philosophy.

The study was conducted from October 2023 to April 2024. The study relied on primary data that was collected among 205 managers or owners of MSMEs in Nairobi County.

1.6 Significance of the Study

This work will benefit the following actors:

1.6.1 Policy and Decision Makers

The MSMEs subsector is a target for policy making due to its importance to the national and county economies. Therefore, this study hopes to be of significance to policy and decision makers as it will make recommendations for implementing the Kenya Investment Policy 2019 and the National Trade Policy 2017 that aim to support MSEs through access to affordable credit.

1.6.2 Commercial Banks

The banking sector has always made efforts in designing and introducing innovative products that are aimed at creating opportunities for MSMEs to borrow successfully. In this way, this study hopes to make recommendations for the banking sector which if adopted can contribute to increasing borrowing requests from MSMEs and fostering greater relationships between these sectors.

1.6.3 Micro and Small Enterprise Authority

This investigation hopes to benefit the Micro and Small Enterprise Authority (MSEA) as the agency mandated to advocate for the growth of the MSME subsector. The recommendations if adopted will spur financial partnerships between MSMEs and other financial actors other than banks in an effort to provide a myriad of sources from which they can benefit from loans.

1.6.4 Micro, Small, and Medium Enterprises

This research hopes to benefit entrepreneurs in the MSME sector as it provides insight into the borrower discouragement phenomena. By participating in this study, entrepreneurs will get the opportunity to share their experiences with borrower discouragement and inform regulators and policy makers on how to improve the relationship between enterprises and the banking industry.

1.6.5 Scholars and Academia

Much research on borrower discouragement has been conducted in European, Western, and Asian contexts and less in the African context and more so in Kenya. Therefore, this study contributes to empirical evidence and body of knowledge on MSME borrower discouragement while refuting or confirming adopted theories.

1.7 Chapter Summary

The foregoing chapter has elucidated the background of the study, problem statement, objectives, research questions, scope and significance of the study. In the next section, theoretical, conceptual and empirical review will be presented.



CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This section captures the literature on theories and empirical evidence in regard to the phenomenon of borrower discouragement. It also presents an outline of the research gaps that the study aimed to fill. A conceptual framework is also developed from the empirical findings as well as an operationalization of the research variables.

2.2 Theoretical Review

Theoretical review allows researchers to select theories from a wide range that exist to show how they are relevant to their research. Specifically, theories are used to provide an explanation of interrelationships between concepts for variables under investigation. In this research, the General Systems Theory (Von Bertalanffy, 1962), the resource-based view (RBV) of the firm (Wernerfelt, 1984), the Institutional Theory (Zucker, 1987) and the Deterrence Theory (Tittle, 1969) underpin the theoretical framework.

2.2.1 General Systems Theory

Von Bertalanffy (1956) is credited with proposing the systems theory which is an interdisciplinary concept that each organization has to interact with its environment. Systems theory argues that for an organization to survive, such as a living organism, it should operate in an open system that has inter relations internally and externally. The concept of organizations as systems is widely recognized as an approach that can be matched to each organization, to achieve greater efficiency and efficacy in a dynamic environment (Chikere & Nwoka, 2015).

The management system of an organization is comprised of different subsystems that require to be matched with each other. More complex subsystems develop as the company grows to coordinate the transforming of inputs to outputs. The interdependencies between subsystems can become so multiplexed that a change in one can result in significant unintended consequences in other parts of the organization. The system approach's main argument is that a company does not exist in isolation but is

dependent on its external environment which is part of a larger system such as the industry it operates in (Chinedu & Chinedu, 2018).

Criticism to systems theory have been noted by various scholars, including that it is seen as an amalgamation of different theories including decision theory, contingency theory and general systems theory (GST). Its applicability is also limited by the fact that it does not provide precise relationships among organizations and the external system or have a framework that can be applied to all organizations.

The systems theory however, accedes to this study as it proffers the scope from which to include demand and supply-side factors that may contribute or inhibit borrower discouragement among MSMEs. The theory recognizes the importance of individual characteristics of the entrepreneur and how these may contribute to borrower discouragement while also taking notice of organizational factors. The business environment also has contextual factors that can contribute to borrower discouragement and using a system approach provides the opportunity to include these factors into the research.

2.2.2 Resource Based View

The resource-based view (RBV) associated with Wernerfelt (1984) and further developed by Barney (1986; 1991) argues that enterprise outcomes are not due to external factors but rather are a result of its internal factors. The inner disposition of a company influences its standing in the competitive space; this refers to its resources which are; human (training, experience, insights), organizational (formal structure), and physical (physical, technological, plant and equipment). These resources allow it to create and adopt tactics that engender increased effectiveness and efficiency (Barney, 1991).

The RBV contends that competitive advantage can be built by exploiting the resources that meet the valuable, rare, inimitable and non-substitutable (VRIN) criteria. A valuable resource is one that has a strategic value to an organization; it must also be difficult to locate among other rivals of the firm; inimitable resources are those that cannot be copied or emulated in the market and non-substitutable resources are those that rivals cannot substitute for in the market (Chigara, 2021).

Several issues have been raised on the applicability of the RBV. The RBV has been accused of only being applicable to large firms because in today's highly dynamic environments, VRIN resources are acquired only by firms which are large (Chigara, 2021). Secondly, RBV must answer the questions of how firms are able to maintain the distinctiveness of products, when products are similar and how this maintains a low-cost position without much investment so as to attain above normal profits. Lastly, the RBV does not provide managers with the process of how VRIN resources are identified and developed or acquired (Chigara, 2021).

The RBV however recognizes the importance of human, physical, and organizational resources and their importance to achieve higher goals for an enterprise. The human resources that can contribute to MSMEs outcomes include networking, entrepreneurial spirit, resilience, experience, and training/education. The location, form of ownership, age, size, and structure of an organization can also influence borrower discouragement. The RBV has been used in other research (Godwin-Opara, 2016; Owen et al., 2023) to examine the determinants of borrower discouragement.

2.2.3 Institutional Theory

Institutional theory looks at how formal and informal structures such as schemes, rules, norms and routines, become established as authentic guidelines for social behavior. Institutional theory explains the evolution of structures from creation, to dissemination, adoption and desertion over time (Ozili, 2023). Institutional theory states that individuals are influenced by regulatory, normative and cognitive institutions which determine appropriate behavior and grant entrepreneurs' legitimacy (Naegels et al., 2021).

A view of financial inclusion from a formal and informal institution perspective, is important because the organizational features such as codes of conduct, procedures, policies and structures differ and these guide people's way of thought and how they interact with financial actors. In the long run, this engagement can elicit `for or `against outcomes that impact on the uptake of financial services in society (Ozili, 2023). According to Naegels et al. (2021), the commercial ecosystem in developing countries or emerging markets is "antagonistic in socio-economic, civil and political norms.

The institutional theory of financial inclusion assumes that firms have insufficient information on formal financial services under various categories. Some firms will hold partial information on how to engage with official financial channels; others will have little knowledge on what provisions they must adhere to in order to obtain financing; and some will have no information on constraints and risks they will face. Firms need to be versed with the risks associated with bank failure, multiple transactional costs and other prejudices that limit access such as the level of income, and ethnicity (Ozili, 2020).

The institutional theory has been used by previous researches (Osebo, 2017; Naegels et al., 2021) to stress the effect of institutional voids on the supply of business finance where it leads to discrimination and a lack of credit providers. These studies have used the theory to explore entrepreneurs' perceptions of the institutional business environment on financing behavior. Therefore, institutional theory provides the mechanism to understand the influential factors in the business environment that may hinder MSMEs in seeking loans from financial institutions.

2.2.4 Deterrence Theory

The deterrence theory was postulated by classical thinkers such as Cesare Beccaria (1738–1794), Jeremy Bentham (1748–1832) and Thomas Hobbes (1588– 1678). The rationale of deterrence theory is reflected in the criminal justice systems, which is to discourage offenders from committing crimes (Sirmal et al., 2017). The underlying assumption is that there is a linkage between an individual's perceptions and actions. General deterrence and specific deterrence are witnessed as a result of communicated sanctions or punishments towards a given crime (Tomlinson 2016). This study adopts deterrence theory to show how measures adopted by commercial banks and other financial institutions can deter MSMEs from applying for loans.

In their research, Balkenhol and Schütte (2001) concluded that the cost benefit of pursuing collateral pledged for micro loans is often cited by banks as a principal constraint to offering such products. The entrepreneur's decision to seek formal financing includes a review of past experiences and sanctions that would accrue if the loan is unpaid. Naegels et al (2021) found that women were hesitant to apply for formal loans when they witnessed the penalties applied to others who were unable to repay. These borrowers experienced general deterrence (Tomlinson 2016).

Warundu (2021) linked deterrence theory to tax adherence determinants which include associated costs, technology complexity, rate of tax, fines and other punitive sanctions. He found that taxpayers analyzed these costs and if high they formed a disincentive to comply. Sirmal et al. (2017) however explained that the Credit Reference Bureau (CRB) listing policy has been effective in improving repayment within the Higher Education Loans Board (HELB) and has highly contributed to HELB loan recovery.

Based on perspectives from previous studies (Warundu 2021, Sirmal et al 2017), banks have taken some measures that have increased the gravity of non-compliance in the event of default so as to dissuade perpetrators and spur repayment. These measures had an inverse effect of MSMEs self- selecting out of the credit market and thereby deterring formal loan applications.

2.3 Empirical Review

Below are presentations of empirical evidence from research that has explored the associations and relationships between entrepreneur characteristics, firm-level characteristics, and business environment with borrower discouragement focusing on MSME industry.

2.3.1 Entrepreneur Characteristics and Borrower Discouragement

The entrepreneur characteristics have been shown to be an important determinant to enterprise outcomes. Many scholars agree that an individual's ability and willingness to bear risk is influenced by their demographics viz age, gender, education, experience and sophistication. Small firms have little diversification and separation of ownership from control (Ang et al 2010). Personal and business assets tend to be pledged to acquire financing hence the owner's demographics have a bearing on financing decisions. The studies below show various relationships that have been observed between borrower discouragement and entrepreneur characteristics.

Cole and Sokolyk (2016) conducted multivariate tests on panel data from the U.S Small Business Finances survey (1993 to 2003), that revealed that entrepreneurs' age was a significant factor in borrower discouragement. Older business owners were found to be more reliable and credible because of an extensive track record and hence less

discouraged while young entrepreneurs were high risk and hence more discouraged. Omar (2018) asked a total of 1,425 Malaysian enterprises what contributed to their discouragement and found that age significantly predicted borrower discouragement. Rahman and Zbrankova (2020) however, utilizing Business Environment and Enterprise Performance Survey (BEEPS) data for the period 2012- 2014 from a sample of 1,296 SMEs; revealed that a loan application from an older firm was likely to be rejected and they were hence discouraged. These results were not statistically significant but contrast the other findings necessitating the need for the researcher to study this variable further.

In terms of experience, Bar-El, Gaviols, Kaufmann, and Schwartz (2018) used a qualitative study utilizing in-depth interviews in Israel to assess entrepreneur's perception on financing decisions and found that longer tenure Chief Executive Officers (CEOs) were the most discouraged. In an emerging markets study Gama et al. (2017) conducted tests to compare the features of loan applicants and discouraged borrowers and found that higher levels of discouragement were prevalent with those with higher experience having greater chances of being discouraged. Using a probit model to study how entrepreneurial perception affects discouragement, Morales (2022) found that entrepreneurs in France were generally aware of the limitations in the credit market but mis-calibration (over-confidence) induced them to dwell only on pessimistic perceptions, ignoring peer experiences and underestimating the possible variations of outcomes. They became discouraged by amplifying the social and psychological costs of their decisions. These researches were limited to secondary data sources but there is a need for primary data sources on discouragement from emerging economies where there is limited enterprise data.

Other studies indicate that gender is related to borrower discouragement, Galli et al. (2018) analysed 60,058 observations from a SAFE dataset in 11 EU nations and found that female-owned SMEs had a higher chance of refraining from loan applications than did their male counterparts. Using a qualitative methodology, Naegels et al. (2021) research in Tanzania determined that prior rejection discourages follow-up applications but also that interest rates and fear of collateral seizure discourages most women from taking up formal loans. However, there is inconclusive research on what role gender plays in discouragement.

Rahman and Zbrankova (2020) using a sample of 1,296 SMEs under the Business Environment and Enterprise Performance Survey (BEEPS) data 2012- 2014 found that enterprises owned by women did not influence the likelihood that their applications would be accepted by banks. Freel et al. (2012) following a postal survey among UK SMEs found that there were significant differences between discouraged borrowers in respect to applicants concluding that gender and discouragement were not significantly related. In their study, DiCaprio, Yao, and Simms (2017) also found there was no variation among gender in terms of borrower discouragement. The literature is therefore not conclusive on the role of gender in discouragement among MSMEs.

Education is an owner characteristic that has been found to explain marked differences in borrower experiences in the market. Nguyen et al. (2020) in a Vietnam study using a probit regression model investigated the association among credit self-rationing and education. His findings indicated that those entrepreneurs with a university education had a higher likelihood of loan application as compared to those with lower education who were discouraged by the extensive application procedures. On the contrary, a study by Cowling et al. (2016) during the banking crisis in United Kingdom (UK), disclosed that owners/managers with higher education were more likely to suffer discouragement. They opted not to bother applying for loans in the anticipation that they would be denied.

2.3.2 Firm Characteristics and Borrower Discouragement

A firm's features such as age, size and industry impact on both the need for credit and ability to obtain it. The firm's investment decisions are correlated with its history and determined by its propensity to mobilize requisite resources. Borrowing costs are based on the enterprise attributes and scholars show that mature firms have higher probability of holding more assets, be well known and have better relationships with banks. This translates to lower borrowing costs which could influence the incidence of discouragement. Empirical findings in this section however, show varied results.

Undertaking a comparison across developed and developing countries, Chakravarty and Xiang (2013) used a simple regression model to show that borrowers in underdeveloped economies were significantly more discouraged across various firm characteristics; a

higher GDP growth rate lowered the likelihood of borrower discouragement. Firm size was found to be a pivotal determinant of the likelihood of discouragement with small sized firms exhibiting 28.65% discouragement rate, medium firms 49.2% and large firms 22.2%. The research examined the differences in developed and underdeveloped economies but this study will be limited to an emerging economy.

The firm's financial condition has been found to be the most significant indicator of the ability to invest in profitable projects and to seek debt. Chandler (2011) investigated what factors contributed to borrower discouragement of Canadian SMEs using a dataset from the Enterprise Financing Data Initiative (SME FDI). Of the large sample of 12,047 SMEs, the findings did not show significant differences between financial variables and discouraged borrowers. Examining credit needs among small business owners in the U.S., Cavalluzzo and Wolken (2015) found that the firm's finances were the leading reason for application avoidance. In European markets, Bhaird, Vidal and Lucey (2016) used a binomial logit regression model to investigate how enterprise distress contributed to borrowing behaviour and established that reducing turnover, capital reserves and increase debt to asset ratio contributed to discouragement. This distress affected owner's perception and they became dejected about the success of a loan application.

Innovative SMEs are documented in literature as experiencing unmet credit needs due to their reliance on intangible assets and unproven success. Utilizing a probit model on the UK Longitudinal Small Business Survey (LSBS), Brown, Linares-Zegarra and Wilson (2022) documented that introducing product innovation increased the propensity to be discouraged by 6.6% as compared to being non-innovative and that high tech firms were more likely to have application avoidance as compared to ordinary firms. These findings corroborated the study by Bar-El et al. (2017) on the influence of innovation on the propensity to seek external financing but go against those of Freel et al. (2012) who did not find any evidence of SMEs that were strong in innovation with inclination to be discouraged borrowers.

Using data from the Australian Bureau of Statistics, Xiang et al. (2015) investigated effects of firm-level factors on discouragement in firms seeking and not seeking finance, and firms' successfully and unsuccessfully acquiring finance. The evidence was that experience as a discouraged finance seeker significantly affected future

finance-seeking behaviour. This was also confirmed by Freel et al. (2012) using a large-scale postal survey of UK SMEs which showed that prior encounters and banking relationships were a determinant of borrower discouragement.

Owen et al. (2023) adopted a mixed method research to examine demand and supply-side failures in the UK using the data from 15,502 SMEs complemented by interviews with 6 SME finance support advisors. The findings revealed that turnover, growth, sales and employment did not appear to explain discouragement. Betz and Ravasan (2016) used the MENA Enterprise Survey dataset to examine the influence of collateral practices on allocation of credit and found no effects of collateral ratio index on discouragement. These inconclusive findings show that more studies are required on a firm characteristic influence on borrower discouragement.

2.3.3 Business Environment and Borrower Discouragement

The business environment is an important determinant for enterprise outcomes and has also been associated to borrower discouragement. The macro factors such as interest rates and taxes which lead to increased economic costs are likely to influence the firm's decision to borrow. Perceptions of tough times can also cause firms to self-ration out of the credit market. Various studies have been done to test this relationship.

Using a sample of small firms in 9 European countries, Bhaired et al. (2016) looked into the effects of macroeconomic factors on discouragement and found that the GDP, financial distress and level of private sector all had insignificant associations with borrower discouragement. Mol-Gómez-Vázquez et al. (2020) analysed SMEs in EU emerging economies and found that borrower discouragement may decrease or increase with the presence of more foreign banks as the availability of less expensive debt enforcement mechanisms provided opportunities for credit information on individuals and firms. These studies were conducted in Western and European economies that are more advanced than Kenya's economy and therefore this is a gap the study aims to fill.

Anastasiou et al. (2022) used SAFE dataset to test whether Economic Sentiment Indicator (ESI) and its volatility would influence chances for a successful loan application. It was found that high economic uncertainties mean there was a high volatility in the ESI and this increased the chances of borrower discouragement

happening. Cowling and Sclip (2022) used cross-country panel data to measure the intertemporal dynamics of borrower discouragement using data from the SAFE survey in 11 EU nations and 86,388 firm-level observations. The study found that the likely chances for transition from non-discouragement to being discouraged were influenced by macroeconomic factors. These researches were limited to secondary sources of data and did not include primary sources of data which this study aims to do.

Mol-Gómez-Vázquez et al. (2022) provided new information from the connection between a nation's banking system stability and enterprises access to finance using data from 16,382 firms from 2011 to 2018. The results indicated stability in the banking systems meant low levels of discouragement from loan applications and the chances of being discouraged reduced with the inflation levels. Ferrando and Mulier (2022) presented the results on the behaviour and characteristics of discouraged borrowers from the EU using the SAFE dataset and found that enterprises were more discouraged when there was a high interest rate charged by banks while lower discouragement was associated with higher tax rates. These studies utilize secondary data which is limited to the control that researchers have on the information while this research uses primary data where the researcher will have control over what information is collected.

Statnik (2020) used the WBES dataset to determine perceptions and experiences of SMEs on their operating environment and found that there was a connection between corruption and discouragement but this was insignificant but the association was negative. These findings support Galli et al. (2018) who found that corruption did not have any association with borrower discouragement.

Osei-Tutu and Weill (2023) results showed that nations that were more individualistic were less likely to be discouraged as their norms reduced borrower discouragement through lower corruption in lending and weak informal support networks. This evidence indicates there is inconclusiveness in terms of corruption and discouragement; furthermore, the secondary sources of data may not indicate the corruption perceptions of enterprises which this study will seek to collect to determine its relation with discouragement.

2.4 Literature Review Summary

Table 2.1 provides a summary of the reviewed literature and shows the main findings for each study identifying the gaps and how the present study will fill this gap.



Table 2.1: Literature Review Summary

Author	Topic	Main findings	Research Gap	Type of gap	Study filling gap
Chakravarty & Xiang (2013)	The international evidence on discouraged small businesses	Smaller firms were significantly more discouraged	The study relied on secondary data from different nations	Methodological gap	This study uses primary data
Cavalluzzo& Wolken (2015)	Small business loan turndowns, personal wealth, and discrimination	Firm's finances were the leading reason for application avoidance.	The study relied on secondary data from different nations	Methodological gap	This study uses primary data
Xiang et al. (2015)	Discouraged finance seekers: An analysis of Australian small and medium-sized enterprises.	Experience as a discouraged finance seeker significantly affects future finance-seeking Behaviour	The study was longitudinal in nature	Methodological gap	This study will use a cross-sectional research design
Cole & Sokolyk (2016)	Who needs credit and who gets credit? Evidence from the surveys of small business finances	The age of the business owner was found to be significant with creditworthiness	The study used secondary data from a U.S. database	Methodological gap	The study uses primary data from Nairobi County MSMEs
Cowling et al. (2016)	In the post-crisis world, did debt	More educated entrepreneurs were	The study was limited to innovative and	Conceptual gap	This study includes all MSMEs in different sectors

	and equity markets respond differently to high-tech industries and innovative firms?	more likely to be discouraged during a recession	technology-based firms		
Bhaird et al. (2016)	Discouraged borrowers: Evidence for Eurozone SMEs.	Declining turnover lead to discouragement	The study relied on secondary data from different nations	Methodological gap	This study uses primary data
Bar-El et al. (2018)	Under-Investments in innovative SMEs: The effect of entrepreneurial cognitive bias.	longer tenure CEOs were the most discouraged	The study was qualitative in nature thereby not showing associations and relationships between variables	Methodological gap	This study adopts a quantitative approach to make inferences on relationships between variables
Galli et al. (2018)	Does Corruption Influence the Self-Restraint Attitude of Women-led SMEs towards Bank Lending?	Women-led SMEs refrained from applying for loans regardless of the surrounding environment	The study relied on secondary data from different nations	Methodological gap	This study uses primary data
Nguyen et al. (2020)	Debt aversion, education, and credit self-ratoning in SMEs.	Those with a lower education were often discouraged by a burdensome application process	The study limited the scope to lower educated entrepreneurs	Methodological gap	The study includes all MSMEs in Nairobi County

Anastasiou et al. (2022)	Borrower Discouragement Prevalence for Eurozone SMEs: Investigating the Impact of Economic Sentiment	Higher economic uncertainty contributed to discouragement among borrowers.	The study relied on secondary data from different European nations	Methodological gap	This study uses primary data
Cowling & Sclip (2022)	Dynamic Discouraged Borrowers	Being not discouraged to being discouraged was driven by macro-specific factors.	The study relied on secondary data from different European nations	Methodological gap	This study uses primary data
Mol-Gómez-Vázquez et al. (2022)	Borrower discouragement in a bank-based economy: Empirical evidence for Spanish SMEs	Stability of the banking system and inflation influenced level of discouragement	The study relied on secondary data from Spanish MSMEs	Methodological gap	This study uses primary data
Ferrando & Mulier (2022)	The real effects of credit constraints: Evidence from discouraged borrowers	Higher interest rates charged by banks contributed to discouragement	The study relied on secondary data from different European nations	Methodological gap	This study uses primary data

Source: Researcher (2024).

2.5 Conceptual Framework

The conceptual framework explains the relationship between the variables using visual illustrations (Mugenda & Mugenda, 2019). The independent variables are entrepreneur characteristics, firm characteristics and business environment. The dependent variable is borrower discouragement.

Independent Variables

Dependent Variable

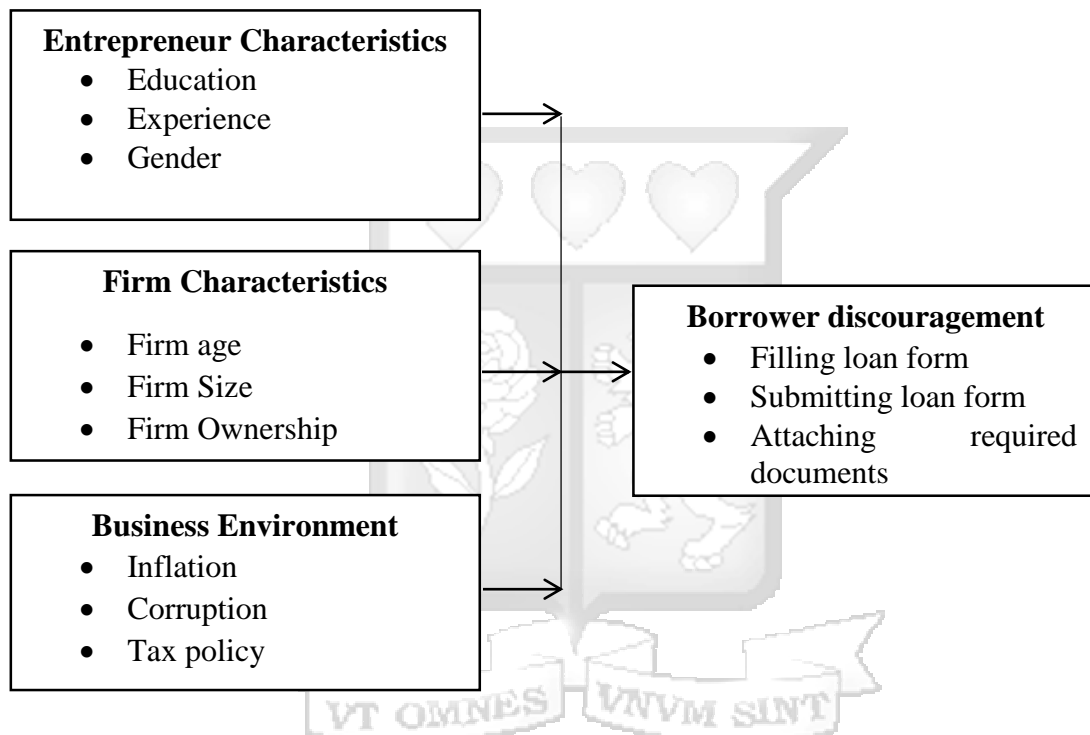


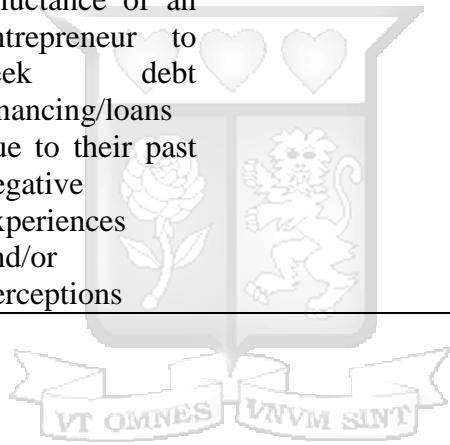
Figure 2.1 Conceptual Framework

Table 2.2: Operationalization of variables

Variables	Perception Indicators	Definition	Scale	Source	Supporting Theory
Entrepreneur characteristics	Education Experience Gender	These refer to the personal characteristics of an entrepreneur and in this study are limited to the entrepreneur's education, experience and gender	Likert scale	Gama et al. (2017); Nguyen & Canh (2021);	General Theory Systems
Firm characteristics	Firm age Firm Size Firm Ownership	These refer to the features of an enterprise such as the age, size and ownership structure of a business.	Likert scale	Bhaired et al. (2016); Chakravarty & Xiang (2013)	Resource Based View of the firm
Business environment	Inflation Corruption Tax policy	These are direct or indirect external elements that have a bearing on the activities of an enterprise such as tax policy, inflation,	Likert scale	Mol-Gómez-Vázquez et al. (2022); Galli et al. (2018)	Institutional Theory

Borrower discouragement	Filling loan forms Attaching required document	<p>and corruption. They are the business environment factors considered in this research</p> <p>This refers to the reluctance of an entrepreneur to seek debt financing/loans due to their past negative experiences and/or perceptions</p>	Likert scale	Brown et al., (2022); Osei-Tutu & Laurent Weill (2023)	Deterrence Theory
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Source: Researcher (2024)



2.6 Chapter Summary

This chapter introduced the GST, RBV Theory, institutional theory, and Deterrence theory as its theoretical underpinning. The empirical literature was done and summarized in a table indicating the research gaps this study aims to fill and development of the conceptual framework and the operationalization of variables.



CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section introduces the positivist research philosophy as the theory of knowledge under which a correlational research design is used. The Nairobi County MSMEs are selected as the targeted population and included into the sample via random sampling methods. The data collection method was a structured questionnaire that was piloted to determine its validity and reliability. The data analysis techniques and ethical requirements are also presented.

3.2 Research Philosophy

Philosophy is the primary study of fundamental and general problems that are concerned with values, knowledge and reality of the world. The objective of philosophy is to find out answers to all questions by using a systematic and critical approach and its dependency on rational argument. The two main fields of philosophy are epistemology and metaphysics of knowledge where epistemology is focused on the scope and nature of knowledge including the relationships between perception, belief, truth and theories of justification (Kenaphoom, 2021).

The study adopted the positivist research philosophy. Positivism focuses and believes on examining tangible and sensitive phenomena; that is, subjects that are measurable, tangible, touchable, and countable (Park et al., 2020). Quantitative research methodology is founded on positivism. Therefore, positivists explore social reality based on philosophical assumptions with an emphasis on reason and observation as a means of understanding human actions while using scientific methods as a means of knowledge creation. This involves manipulation of reality with differences in an independent variable so as to identify regularities in and forming relationships between them (Park et al., 2020). The inquiry was therefore on how the MSMEs internal and external environments' influence borrower discouragement.

3.3 Research Design

A research design is the strategy adopted to answer the research questions and involves the collection, computation and interpretation of data. It enables the selected task by reducing complexities and structuring the approach (Lillykutty & Samson, 2018). The current study applied descriptive correlational research design since it aimed at responding to questions on why, how and what is promoting borrowing discouragement among MSMEs in Nairobi County. Further the study was limited to quantitative data that was sourced through issue of questionnaires.

3.4 Population

The MSMEs in Kenya represent the population for this research. Further described under this subsection are the target group, the sampling techniques and sample size. A well-defined set of services, elements, organisation, or individuals that are of interest to a researcher form a target population (Mncedisi, 2022). Using statistics from MSEA, the target population was 12,429 MSMEs as shown in Table 3.1.

Table 3.1: Target Population

Sector	Count	Percentage
Agri-Business	809	6.5
Manufacturing	2421	19.5
Services	3961	31.9
Traders	5196	41.8
Others	42	0.3
Total	12429	100

Source: MSEA (2024)

3.5 Sampling Technique and Sample Size

To select a sample, an exhaustive list of a population of interest to a researcher is aggregated namely the sampling frame. Based on this, probability sampling is done to agree on a sample. Sampling frames are useful to allow for probability sampling (West, 2016). The sampling frame was the 12,492 MSMEs from which a sample size of 205 was calculated using the Yamane (1967) sample size formula as broken down below.

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

Where;

n = sample size

N = study population

e = tolerance at the preferred level of confidence

$\alpha = 0.07$ at 93% confidence level.

$$n = 12,429 / 1 + 12,429 (0.07)^2$$

$$n = 12,429 / 1 + 12,429 * 0.0049$$

$$n = 12,429 / 60.921$$

$$n = 205$$

Table 3.2: Sample Size

Sector	Count	Percentage
Agri-Business	13	6.5
Manufacturing	40	19.5
Services	65	31.9
Traders	86	41.8
Others	1	0.3
Total	205	100

Source: MSEA (2024)

Using this formula, the final sample size was realised as 205 MSMEs from which one owner and/or manager will be selected for inclusion into the sample size as shown in Table 3.2. Stratified sampling technique was applied in selection of respondents whereby each section was assigned proportionate weight of its population.

3.6 Data Collection Instrument

The primary sources of data were adopted. The rationale for this source is because there exists no repository for secondary data that can provide information on the variables therefore, the data was collected from MSME owner/managers in Nairobi County by a structured questionnaire designed by the researcher. The questionnaire was divided into various sections. Section one, aimed to collect data on the entrepreneur (age, gender,

education level, experience) and the enterprise (location, sector/industry, and ownership structure). Section two collected information on entrepreneur characteristics (gender, experience, education); section three focused on the firm-level characteristics (firm age, size, ownership structure, firm-bank relationship); section four focused on business environment (inflation, corruption, taxation); and section five collected data on borrower discouragement.

The questionnaire was limited to Likert scale data for the variables while incorporating close and open question types for entrepreneur and enterprise information. A 5-point Likert scale that required respondents to indicate their level of agreement with the statements for each of the variables: entrepreneur characteristics (10-items); firm-level characteristics (11-items); business environment (10-items). Borrower discouragement (7 items) was measured by asking respondents about their need for a loan and the subsequent action of completing a loan application or failing to apply.

3.7 Data Collection Procedure

The researcher sought research permit from Strathmore University ethical review committee and applied for research license from National Commission for Science Technology and Innovation (NACOSTI). Further, research assistants were recruited and training more so for those respondents who responded to hard copy questionnaires. In addition, google form was created and was administered amongst respondents so that they may respond to the questionnaire at their own convenience.

3.8 Research Quality

Before the actual administration of the questionnaire, it was piloted amongst 21 MSMEs hailing from Kiambu County. According to Lillykutty and Samson (2018) piloting ought to be carried in a sample of at least 10% of the actual study sample. Piloting of the research instruments enables the researcher to pin point challenges that may deter achievement of desired study objectives due to complexity or inability of the research tool to solicit required data. Kiambu County MSMEs were selected due to their proximity to Nairobi County and being part of Nairobi Metropolitan.

3.8.1 Validity of Research Instrument

Validity is the standard with which an instrument achieves what it sets out to measure; it is the degree to which a tool is accurate in its measurement (Lillykutty & Samson, 2018). Face validity was done among selected participants to determine how well participants understood the wording of the items in terms of clarity, readability, and feasibility. Validity was also determined by presenting the formatting and presentation of items in a manner that is unambiguous (Architha & Sreeramana, 2020).

3.8.2 Reliability of Research Instrument

Reliability is the ability of an instrument to boast of trustworthiness and the extent to the instruments ability to be accurate even being used again and again. The reliability of an instrument refers to its ability to have repeatability when administered in different times and under similar settings (Lillykutty & Samson, 2018). There are different elements to a measurement's reliability namely: inter-rater reliability, test-retest, parallel form, internal consistency, and split-half reliability (Architha & Sreeramana, 2020).

Out of the different methods for testing reliability, the internal consistency approach was deemed adequate for the questionnaire since it was based on Likert scale items. Internal consistency of an instrument is measured using the Cronbach Alpha coefficient (Architha & Sreeramana, 2020). Cronbach's alpha value cited by most scholars is a threshold of 0.70 for an instrument acceptability as reliable. A low value (below 0.7) is considered as poor reliability and therefore this will be used as the cutoff point for accepting the instrument as reliable. The research instrument was reliable since its reliability coefficients were greater than 0.7 as tabulated in Table 3.3.

Table 3.3: Reliability Analysis

Variables	Number of items	Cronbach's	
		Alpha	Comments
Entrepreneurial characteristics	10	0.780	Accepted
Firm level characteristics	11	0.825	Accepted
Business environment	10	0.853	Accepted
Borrower discouragement	7	0.859	Accepted

Source (Research data, 2024)

3.9 Data Analysis and Presentation

The first step of the data analysis was coding data to make it easier to capture into the Statistical Package for the Social Sciences (SPSS) especially for the open-ended questions. This was followed by performing descriptive statistical analysis to summarise the data using frequency distributions for the nominal data while mean and standard deviation (SD) were used for the Likert scale data. The next phase of analysis was performing Pearson (r) correlation analysis and thereafter ordered logit regression model analysis was done to determine influence of independent variables on borrower discouragement. The proposed model was:

$$\text{Logit (Y)} = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where:

Y = Borrower discouragement

X₁ = Entrepreneur Characteristics

X₂ = Firm Level characteristics

X₃ = Business Environment

ε = Error term

3.10 Diagnostic Tests

Ordered logit regression modelling is anchored on four main assumptions that states that dependent variable should be ordered which in the current study was ordered as per five-point likert scale, at least one or more predictor variable can be continuous in the current study all of them were in five-point likert scale. Thirdly, predictor variables should not be affected by multicollinearity and parallel regression ought to have similar coefficients, this assumption was tested using likelihood ratio and Wolfe Gould test. Multicollinearity using spearman's rank correlation coefficient was not greater than 0.8.

3.10 Ethical Considerations

Following the successful defense of the proposal, an ethical clearance (Appendix 2) was granted by the Strathmore University Ethical Review Board (SU-ERB) after which an introductory letter (Appendix 3) was drafted to MSEA so as to obtain a list of MSMEs in Nairobi County. The researcher was also granted a research permit (Appendix 4) from the National Commission for Science, Technology and Innovation (NACOSTI).

3.12 Chapter Summary

The foregoing section has presented research methodology adopted in the study. It has stated and justified the choices of methodological approach in the current study.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter presents analysis and presentation of data. This information is presented in unique sections namely response rate, demographic information, borrower discouragement, entrepreneur characteristics, firm-level characteristics, business environment, association between variables, and relationship between variables.

4.2 Study Response

Out of the 205 questionnaires administered, 152 were returned indicating a response rate of 74.1 % which meets the set threshold in literature. Mugenda and Mugenda (2019) recommend a response rate of 50 % while Booker et al. (2021) indicate 80% or higher is acceptable.

4.3 Basic Information

In this section the results on the demographic information of the owner managers and enterprises are represented.

4.3.1 Respondent Information

This section presents information on age, gender, education level, and entrepreneurial experience of the owner managers. The distribution of the respondent's information was captured and the findings are illustrated in Table 4.1 below. The results revealed more entrepreneurs were in the 35-42 age group and represented 37.5% of the sample followed by those aged 26-35 years (25.0%), 43-50 years (17.1%), over 50 years (13.8%), and the least represented group were those in the 18-25 years (6.6%).

There were more male owner managers in the sample accounting for 58.6% while the remaining 41.4% were female. This finding disagrees with the UNDP MSEA survey 2020 on impact of COVID-19 on MSMEs, that found more women led enterprises 56.4% women as compared to 43.6% male.

The findings indicate that more respondents had a secondary level of education (46.1%) followed by those with a diploma (24.3%), undergraduate degree (19.7%), and those with a postgraduate degree were the least represented. This outcome corroborates the KNBS (2016) survey which found that majority of owners and managers had a secondary level of education but contravenes a Kenya Bankers Association Survey on MSMEs (2021) whose findings were that a majority of owner managers had a graduate level qualification. Generally, most owner managers had acquired formal education.

Table 4.1: Respondent Information

Variable		Frequency	Percent
Age	18-25 years	10	6.6
	26-35 years	38	25
	35-42 years	57	37.5
	43-50 years	26	17.1
	Over 50 years	21	13.8
Gender	Male	89	58.6
	Female	63	41.4
Education	Secondary school	70	46.1
	Diploma	37	24.3
	Undergraduate degree	30	19.7
	Postgraduate degree	15	9.9
Total		152	100

Source (Research data, 2024)

4.3.2 Enterprise Information

This section presents findings on the age of enterprise, size, ownership structure, and location of enterprises. It was observed that most firms had been in operation between 8 – 11 years (38.2 %), followed by those with 0-3 years’ experience (21.7%), more than 11 years’ experience (25.7%), and 4-7 years (14.5%) respectively. The majority of firms can be categorised as middle aged implying good business management practices and established client base. These findings agree with those of the MSME tracker survey of 2023 that found a 71.6% survival rate among its respondents over a 3-year phase including the COVID period.

Most MSMEs were found to be sole proprietorships (57.2%) followed by partnerships (21.7%), limited company (19.7%), cooperative owned (0.7%) and others (0.7%). This

outcome supports KNBS (2016) survey which found that sole proprietors owned most of the establishments at 78.9%, 37.6% and 26.2% within micro, small and medium sized establishments, respectively.

The enterprises were located in the central business district (CBD) 38.8%, Starehe (14.5%), Kibera (12.5%), Embakasi and Westlands (9.2%), Kawangware (5.9%), Kilimani (4.6%), Parklands (3.9%), and Dagoretti business centres (1.3%). The majority of MSMEs are located in business centres where infrastructure and other amenities are conducive to business operations and there is proximity to an array of customers.

The enterprises operated in trading (46%) and 27% were in services. According to the KNBS (2016) MSME survey, majority of MSMEs are in the service sector, with most operating in wholesale and retail trade. The UNDP MSEA survey (2020) however found that the top 5 sectors were manufacturing 34%, services 17%, agriculture 15%, trade 12% and construction 7%.

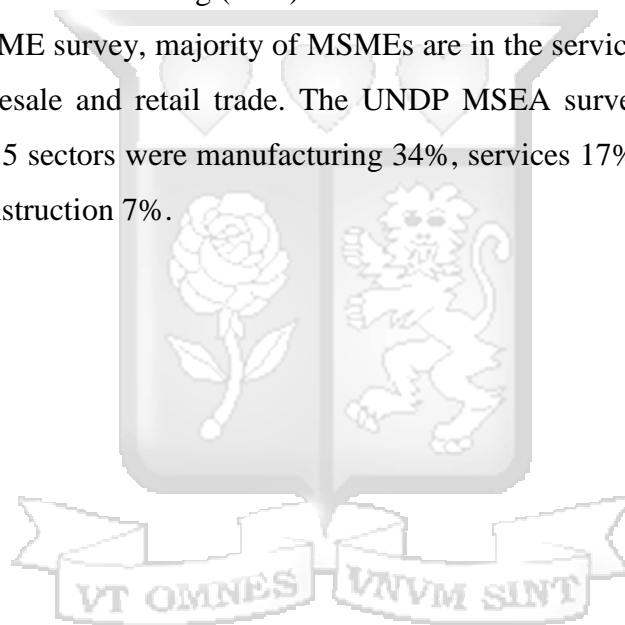


Table 4.2: Enterprise Information

Enterprise Information		Frequency	Percent	
Age	0-3 years	33	21.7	
	4-7 years	22	14.5	
	8-11 years	58	38.2	
	More than 11 years	39	25.7	
Ownership Structure	Limited company	30	19.7	
	Sole proprietorship	87	57.2	
	Partnership	33	21.7	
	Cooperative	1	0.7	
	Other	1	0.7	
Location	Kawangware	9	5.9	
	Kibera	19	12.5	
	Westlands	14	9.2	
	Parklands	6	3.9	
	Nairobi CBD	59	38.8	
	Starehe	22	14.5	
	Dagoretti	2	1.3	
	Embakasi	14	9.2	
	Kilimani	7	4.6	
	Enterprise sector	Agri-Business	8	5
		Manufacturing	32	21
Services		41	27	
Traders		70	46	
Others		1	1	
Total		152	100	

Source (Research data, 2024)

4.4 Descriptive Statistics on Borrower Discouragement

Caglayan et al. (2022) define discouraged borrowers as entrepreneurs who do not engage in loan application due to their negative perceptions of the process which makes them anticipate rejection. Žak (2018) goes further to explain that behaviour by some entrepreneurs not to seek finance despite being in need aptly describes the concept of borrower discouragement. In this section therefore, respondents were asked to indicate if they had desired credit, over the last 12 months prior to the study. Those who indicated they had not needed a loan were excluded from further study. Those who were loan seekers (desired credit) were further asked if they had applied or not. Those who did not apply were considered to be discouraged borrowers. The respondents were asked about their perception on borrower discouragement. The findings were measured

by 7 items on a five-point Likert scale and the mean and standard deviation is summarised in Table 4.3.

The respondent's borrower discouragement was greatly influenced by high taxes that are posing challenge to the business environment ($M=4.56$, $SD=0.678$) followed by high interest rates ($M=4.50$, $SD=0.691$), and high collateral requirements ($M=4.10$, $SD=0.988$). There was moderate agreement among respondents that loan application procedure was complicated ($M=3.18$, $SD=1.227$) and that corruption ($M=2.73$, $SD=1.168$) had an effect on their decision not to borrow. On overall majority reported that were neither nor discouraged from taking loans with mean = 3.30 and standard deviation of 1.08.

Taxes have often been highlighted as a significant factor that affects the MSME sector and the respondents agree that it does influence their decision in loan application. Tax relief and subsidies were indicated as interventions desired by MSMEs in the MSE tracker survey (2023). The Kenya Economic survey (KNBS 2023) further highlights that the Kenyan economy has experienced reduction in domestic demand that is likely to suppress investment. Debt is a tool that facilitates firm investment into positive NPV projects and when borrowers are discouraged growth is hampered. During the period under review the Central Bank of Kenya indicated that the weighted average lending rates by commercial banks had increased from 12.7% in January 2023 to 15.8% in February 2024 (CBK 2024). These sustained high interest rates have discouraged borrowers as reflected in our findings.

Table 4.3: Respondents' Perceptions to Borrower Discouragement

Borrower discouragement	Mean	Std. Deviation
Loan application procedure is too complicated	3.18	1.277
Interest rate is too high	4.50	0.691
Collateral requirements are too high	4.10	0.988
Corruption exists in allocation	2.73	1.168
Do not expect to get approved because of my gender	1.95	1.383
Do not expect to get approved due to my years of experience	2.11	1.372
High taxes make the business environment challenging	4.56	0.678
Overall mean score	3.30	1.08

Source (Research data, 2024)

4.4 Descriptive Statistics on Entrepreneur Characteristics

The first objective of the study sought to examine the effect of entrepreneur characteristics on borrower discouragement. To respond to it the study sought the level of agreement on a five-point likert scale as shown in Table 4.4.

The findings show that respondents were in moderate agreement that experience in an industry was likely to influence the chance to access a loan ($M=3.68$, $SD=1.320$). This implies that tested industry knowledge is an added advantage when it comes to applying for loans. Bank officials may view it as a positive indicator of the ability of the business to succeed and hence give approval for financing. Managers with experience also have networks and connections that give them credibility and this further enhances their chances of being successful in their application.

There was disagreement that no difference existed in the willingness to apply for loans between male and female entrepreneurs ($M=2.57$, $SD=1.572$). This implies that both male and female entrepreneurs were both willing to apply for loans to meet their enterprise needs. There is a perception however that women-led enterprises are less likely to apply for loans as gender has been shown to explain differences in risk-aversion with men more likely to take up debt to advance their business. This result however suggests that gender does not influence the decision to apply for a loan among Nairobi County entrepreneurs.

The respondents were also in disagreement that education does not matter when it comes to finance ($M=2.71$, $SD=1.499$) suggesting that education was not considered an important factor by banks in loan assessment. The perception however was that those individuals with higher education levels are knowledgeable on the different paths to seeking credit and were more likely to apply for loans. Respondents also indicate that education level does not influence their decision to apply for loans. This suggests that debt is a popular financing instrument among MSMEs in Nairobi County irrespective of their level of education.

Table 4.4: Descriptive Statistics on Entrepreneur Characteristics

Entrepreneur characteristics	Mean	Std. Deviation
Experience as an entrepreneur in a particular industry, increases chances of acquiring finance	3.68	1.320
There is minimal experience required to be successful in loan application	2.54	1.361
Experience has nothing to do with issue of finance, as long as other requirements are met	2.88	1.433
The higher the level of education an entrepreneur has attained determines access to debt finance	2.56	1.356
Educated entrepreneurs access finance easily because they are aware of the requirements	3.20	1.387
The education level of an entrepreneur does not matter in the issue of finance	2.71	1.499
There is no difference in the willingness to apply for loans between male and female entrepreneurs.	2.57	1.572
The banks are biased in the processing of loan applications between male and female-owned enterprises	3.31	1.484
Gender has nothing to do with issue of finance once other requirements are met	3.57	1.503
Overall mean score	3.00	1.435

Source (Research data, 2024)

4.5 Descriptive Statistics on Firm-level Characteristics

The second objective sought to determine the effect of firm level characteristics on borrow discouragement, all measured at a five-point Likert scale. The findings are as shown in Table 4.5.

In terms of firm size, respondents were in moderate agreement that firm size was not a determinant for accessing loans ($M=3.74$, $SD=1.131$). These findings imply that the size of an enterprise was not a determinant of the outcome of applying for a loan. It also suggests that lenders may be looking at other aspects of an enterprise such as corporate governance, financial management, and business plans which demonstrate the ability to repay a debt.

Respondents were in moderate agreement that ownership structure was a factor in accessing loans ($M=3.90$, $SD=1.211$). This finding indicates that debt uptake is

influenced by how the organisation makes its decisions. Where there is concentrated ownership, risk aversion may arise because of the difficulty to separate business and owner risk.

The findings indicated disagreement that having multiple bank accounts was associated with access to loans ($M=2.87$, $SD=1.448$). The respondents were of the opinion that having several bank accounts may not contribute to a successful loan application. The assumption here was that having several accounts in banks would show the ability of an enterprise to have relationships with other banks. However, these accounts may also lower the chances to build and deepen trust which is key to MSME lending and scattered cash balances may impact a demonstration of good turnover.

Table 4.5: Descriptive Statistics on Firm-level Characteristics

Firm-level characteristics	Mean	Std. Deviation
The duration that a firm has been in existence influences its chances to access debt finance	3.05	1.466
The longer a firm has been in operation in an industry does not influence its chances to access debt finance	3.16	1.433
The more times an enterprise applies for debt finance the better chance it has of receiving a loan	3.18	1.289
Large number of employees is an indicator that the business is reputable therefore can access finance	3.39	1.235
The firm size does not matter at all as long as other requirements are met	3.74	1.131
The amount of turnover from a business does not matter in accessing debt finance	3.18	1.453
The registration or non-registration status of an SME matters in access to debt finance	3.24	1.399
The ownership structure of an enterprise matters in their access to debt finance	3.90	1.211
A longer banking relationship increases the chances of an enterprise to access financing	3.38	1.352
Multiple bank accounts held in multiple commercial banks increase the chances of an enterprise to access finance	2.87	1.448
The length of a banking relationship does not influence the chances of getting finance as long as other requirements are met.	3.28	1.501
Overall mean score	3.30	1.356

Source (Research data, 2024)

4.6 Descriptive Statistics on Business Environment Characteristics

The third objective of the study examined the effect of business environment characteristics on borrow discouragement. Business environment characteristics was operationalized as inflation, corruption, and taxation measured on a five-point Likert scale as summarised in Table 4.6.

The findings revealed there was moderate agreement that inflation was a concern when applying for a loan ($M=3.90$, $SD=1.227$). Inflation is one of the critical macroeconomic variables since it has a major effect on the application of monetary policy and also affects other vital macroeconomic variables such as interest rates, exchange rates, and stock prices. Inflation rates in Kenya have also been notably unstable over the past five decades being driven by both demand-side and supply-side shocks (Muturi, 2015). Therefore, inflation remains a concern for MSMEs since the rising consumer price index (CPI) negatively affects their businesses.

The respondents moderately agreed that corruption was associated to self-restraint to seek loans ($M=3.63$, $SD=1.091$). This implies that respondent's perception was that there was some element of corruption in the banking sector and therefore had no chance to successfully apply for loans. There is evidence (Mwangi & Ndegwa, 2020; Imbahala, 2019) of fraudulent activities among commercial banks in Kenya and this may be attributed to this finding. The result suggests entrepreneurs perceive that they were less likely to successfully apply and receive loans and therefore restrain themselves from applying for loans.

The respondents were in agreement that high fees for permits and licences influenced their decision to apply for loans ($M=4.23$, $SD=0.895$). There is evidence (Mundia, 2020; Syafrizal & Djamaluddin, 2023) to support the perception from respondents on costs associated with permits and licenses as an obstacle for MSMEs performance. This suggests that due to high compliance costs, entrepreneurs are less inclined to apply for loans.

Table 4.6: Descriptive Statistics on Business Environments Characteristics

Business environment	Mean	Std. Deviation
The high rate of inflation is a concern when seeking debt finance for my enterprise	3.90	1.227
The high rate of inflation increases the costs for seeking debt finance for my enterprise	3.87	1.143
The high rate of inflation increases the price of goods and services for my enterprise	3.52	1.433
The corruption experienced in the country can determine whether your loan application is approved or rejected by the banks	3.22	1.387
The level of corruption in the country contributes to my self-restraint to apply for a loan	3.63	1.091
The high levels of corruption impede my enterprise from applying for bank loan	3.63	1.161
The high fees for permits and licenses increase the cost of operating my enterprise and reduce my willingness to borrow.	4.23	0.895
The changing tax policies in the country lead to high cost of borrowing through high interest rates	4.14	0.854
The high tax rates experienced in the country pose a high risk for my enterprise	3.41	1.407
Overall mean score	3.73	1.177

Source (Research data, 2024)

4.7 Correlation Analysis

The Pearson (r) correlation analysis was done to examine association between independent variables (entrepreneur characteristics, firm-level characteristics, and business environment) and borrower discouragement at the 95% confidence level as summarised in Table 4.7. Correlation analysis depicts that there was a positive statistically significant effect between entrepreneur characteristics and borrower discouragement ($\rho = 0.785$, p value < 0.05). Secondly, firm level characteristics has positive statistically significant effect on borrower discouragement ($\rho = 0.833$, p value < 0.05). Further, business characteristics has positive statistically significant effect on borrower discouragement ($\rho = 0.783$, p value < 0.05). There were no chances of multicollinearity amongst variables under examination since none of them had correlation coefficient greater than 0.7.

Table 4.7: Correlation Analysis

		Borrower discouragement	Entrepreneur characteristics	Firm level characteristics	Business environment characteristics
Borrower discouragement	Correlation Coefficient	--			
	Sig. (2-tailed)	1			
	N	152			
Entrepreneur characteristics	Correlation Coefficient	.785**	--		
	Sig. (2-tailed)	0.000	1		
	N	152	152		
Firm level characteristics	Correlation Coefficient	.833**	.102**	--	
	Sig. (2-tailed)	0.000	0.000	1	
	N	152	152	152	
Business environment characteristics	Correlation Coefficient	.783**	.206**	.018**	--
	Sig. (2-tailed)	0.000	0.000	0.000	1
	N	152	152	152	152

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

Source (Research data, 2024)

4.8 Diagnostic Test Results

Diagnostic test results confirmed that ordered logit was the most optimal model for examination of the effect of entrepreneurial characteristics, firm level characteristics and business environment characteristics on borrower discouragement. As per Table 4.8, no p value was less than 0.05 hence there was no evidence to support rejection of the null hypothesis that parallel regressions have different slope coefficients.

Table 4.8: Diagnostic Test

Test	Chi square	Df	P value
Wolfe Gould	26.68	9	0.542
Brant	31.86	9	0.054
Score	52.49	9	0.362
Likelihood ratio	28.81	9	0.632

Wald	20.62	9	0.620
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Source (Research data, 2024)

4.9 Ordinal Logit Regression Analysis

Ordinal logit regression analysis was carried out to examine the effect of entrepreneur characteristics, firm level characteristics and business environment characteristics on borrower discouragement of MSMEs in Nairobi County Kenya and the findings are represented below.

Table 4.9: Ordered Logit Regression Analysis

Borrower discouragement	Coef.	St.Err.	t-value	p-value	Sig
Entrepreneur characteristics	.711	.252	2.82	.000	*
Firm level characteristics	.672	.332	2.03	.043	**
Business environment characteristics	1.759	.367	4.79	0.00	***
cut1	.123	1.249	.b	.b	
cut2	1.946	.895	.b	.b	
cut3	4.506	.872	.b	.b	
cut4	8.373	1.091	.b	.b	
Mean dependent var		3.980	SD dependent var		0.748
Pseudo r-squared		0.429	Number of obs		153
Chi-square		75.906	Prob > chi2		0.000

*** $p < .01$, ** $p < .05$, * $p < .1$

Source (Research data, 2024)

Model

Borrower Discouragement = $0.711 \times \text{Entrepreneur characteristics} + 0.672 \times \text{Firm level characteristics} + 1.759 \times \text{Business environment characteristics}$

As per results in table 4.9, the model has likelihood chi square of 75.906 and p value of 0.000. It has significant prediction of the selected factors on borrower discouragement as compared with nil predictors model. Pseudo R squared of 0.429, indicated that 42.9% of changes in borrower discouragement of MSMEs in Nairobi County is associated

with entrepreneur characteristics, firm level characteristics and business environment characteristics.

The first objective of the study sought to examine the effect of entrepreneur characteristics on borrow discouragement in Nairobi County. Statistically, entrepreneur characteristics has a positive significant effect on borrower discouragement as reflected in 0.711 log odds. Therefore, a unit increase in entrepreneur characteristics while holding constant firm level and business environment characteristics increases borrower discouragement.

The second objective examined the effect of firm level characteristics on borrow discouragement in Nairobi County. The findings are that there was a positive statistically significant effect of firm level characteristics on borrower discouragement. With a unit increase in firm level characteristics increasing borrower discouragement by 0.672 in the log odds of borrower discouragement.

The third objective sought to determine the effect of business environment characteristics on borrow discouragement in Nairobi County Kenya. The study found that there was a positive statistically significant effect of business environment characteristics on borrower discouragement. Hence, we conclude that a unit increase in business environment characteristics increases borrower discouragement by 1.759 in the log odds of borrower discouragement.

4.9 Chapter Summary

This chapter presented the response rate achieved by the study. The demographic information of respondents was also highlighted followed by a description of the enterprise characteristics. Descriptive summaries were provided for each of the four independent and dependent variables in mean score and standard deviation. This was followed by correlation and regression analysis between the variables.

CHAPTER FIVE

SUMMARY, DISCUSSIONS, CONCLUSIONS, AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings, the discussion of findings which involves comparing and contrasting the results with previous research. The conclusions and recommendations for policy and action are given while suggesting areas for further research.

5.2 Summary of Findings

This research examined factors contributing to borrower discouragement among MSMEs in Nairobi County guided by four specific objectives. These were: to determine the influence of entrepreneur characteristics, firm level characteristics, and business environment on borrower discouragement. The study findings depicted that entrepreneur characteristics, firm level characteristics and business environment characteristics had positive statistically significant effect of borrower discouragement. They jointly accounted for at least 42.9% of borrower discouragement.

5.3 Discussions

5.3.1 Entrepreneur Characteristics and Borrower Discouragement

The first objective of the study sought to determine the effect of entrepreneur characteristics on borrower discouragement. The findings indicated that entrepreneur characteristics had positive effect on borrower discouragement among MSMEs in Nairobi County. The results agreed with Gama et al. (2017) and Chakravarty and Xiang (2013) who found that entrepreneur characteristics had a positive significant relationship with borrower discouragement driven by the experience of the entrepreneur. Cowling (2016) however documented a negative significant effect of experience on discouragement with pessimism increasing among more experienced managers during the global recession. The evidence could have been influenced by the

current economic challenges in Kenya where the market is repressed and borrowers are generally hesitant to borrow across both categories.

On the gender aspect descriptive statistics revealed that gender had no relationship with discouragement among entrepreneurs in the sample. This supports findings by Naegels et al. (2021) that perception of gender discrimination is not evident among discouraged borrowers as informants do not feel loan officers discriminate against women. They however, disagree with Galli et al. (2018) observations that women-led enterprises were more likely to be discouraged borrowers and Caglayan et al. (2022) conclusion that female entrepreneurs are more likely to be discouraged after a failed attempt in China.

5.3.2 Firm Level Characteristics and Borrower Discouragement

The second objective of the study examined the effect of firm level characteristics on borrower discouragement. The results indicated that firm level characteristics of firm age, size, ownership, and relationship with a bank have significant effects on borrower discouragement. Chakravarty and Xiang (2013) found that firm size is a significant determinant of the likelihood of discouragement especially in emerging markets with smaller younger firms being more discouraged. Respondents agreed that the aspects of ownership structure sway the enterprise likelihood of loan application and size of the firm proxied by number of employees influenced their perception.

Findings indicate that a longer banking relationship influences the likelihood of loan application. This agrees with Contrary, et al. (2021) who found that firms that have a long banking relationship have low chances of discouragement. It further supports Gama et al (2017) evidence that a pre-existing relationship with banks enhances information exchange between borrowers and lenders hence reducing discouragement.

5.3.3 Business Environment and Borrower Discouragement

The third objective examined the effect of business environment characteristics on borrower discouragement in MSMEs in Nairobi County Kenya. The study found that there was a positive statistically significant effect of business environment factors on borrower discouragement. The findings agreed with those of Anastasiou et al. (2022)

that entrepreneurs evaluate likelihood of receiving loans from the performance of the economy and use factors such as inflation and taxation to judge their credit-worthiness and the probability of a successful application.

Inflation and high taxes were found to greatly determine the likelihood that an enterprise would avoid loan application despite needing credit. This was similarly documented by the MSE tracker survey (2023) as the greatest challenge to MSMEs with most agreeing that business factors of inflation and taxes increased cost of doing business and decreased their ability to service debt.

5.4 Conclusion

The study's objective examined effect of entrepreneur characteristics on borrower discouragement among MSMEs in Nairobi County and the results indicated there was a positive significant relationship between entrepreneur characteristics (experience, education, gender) on borrower discouragement. The study therefore concludes that entrepreneur characteristics influence borrower discouragement.

The second objective was to determine how firm level characteristics affect borrower discouragement among MSMEs in Nairobi County. The study findings were that there was a positive significant relationship between firm characteristics and borrower discouragement. The study therefore concludes firm characteristics influence borrower discouragement.

The third objective was to determine the effect of the business environment on borrower discouragement among MSMEs in Nairobi County. The findings revealed a statistically significant relationship between business environment (inflation, corruption, taxation) on borrower discouragement. Therefore, it is the study's conclusion that business environment factors affect borrower discouragement.

5.5 Recommendations

5.5.1 Recommendations for Policy

MSMEs mainly rely on the decision-making capability of the entrepreneur and maybe administratively constrained when it comes to seeking financing. The study findings show that entrepreneur characteristics significantly influence borrower discouragement. It is our recommendation that targeted training programmes for MSMEs through the Kenya Bankers Association be regularly undertaken focusing on loan application procedures, requirements and proper use of funds. This will close gaps in credit products knowledge and address apprehension that maybe therein.

Taxes generate funds for national and county government expenditure and MSMEs as profit generating entities are required to pay tax. There is need however to look at the burden of taxation including instances of double taxation on these enterprises. Tax incentives such as exemptions and tax holidays should not only be extended to export processing zones but also to those industries identified as key to the Kenyan economy. A more creative tax policy will assist MSMEs reduce operating costs and have funds for business re-investment.

5.5.2 General Recommendations

There is need for creation of a centralized source of business information and eradication of the levels of information asymmetry so as to minimize its costs. This would enable borrowers to make informed decisions. There is need for nationalization of MSMEs credit support institutions so as to enhance the likelihood of credit access and lower odds of borrower discouragement.

5.5.3 Recommendations for Further Research

Subsequent studies should rely on mixed sources of data and consider triangulation so as to complement short comings associated with each type of data. There is need for a wider scope of the study and inclusion of business enterprises drawn from different counties so as to better understand whether there is any significant difference in

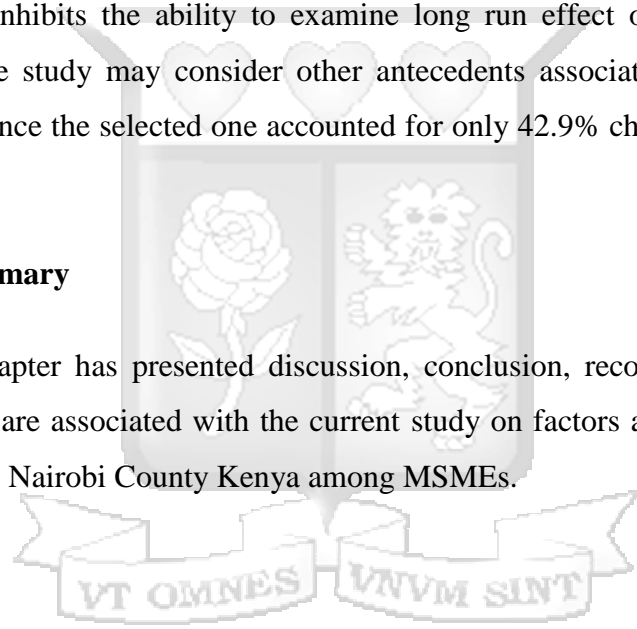
borrower discouragement and respective predictors in selected group of respondents. Secondary data from different sources ought to be considered so as to fully understand the longitudinal effect of the selected antecedents on borrower discouragement over a period of time.

5.6 Limitations of the Study

The current study was limited to a target population drawn among MSMEs hailing from Nairobi County. Therefore, generalizability of the findings to other regions is not possible. The study was limited to self-reported data drawn from owners and managers of MSMEs and this may be associated with some biases. Adoption of descriptive cross-sectional design inhibits the ability to examine long run effect of variables under consideration. The study may consider other antecedents associated with borrower discouragement since the selected one accounted for only 42.9% chances of borrower discouragement.

5.7 Chapter Summary

The foregoing chapter has presented discussion, conclusion, recommendations and limitations which are associated with the current study on factors affecting borrower discouragement in Nairobi County Kenya among MSMEs.



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APPENDICES

Appendix 1: Questionnaire

Section 1: Personal Characteristics

1. Please indicate your age

- 18-25 years
- 26-35 years
- 35-42 years
- 43-50 years
- Over 50 years

2. Please indicate your gender

- Male
- Female

3. Please indicate your education level

- Certificate
- Diploma
- Bachelor's Degree
- Postgraduate Degree

4. Please indicate your years of experience as an entrepreneur

- 0-3 years
- 4-7 years
- 8-11 years
- More than 11 years

Section 2: Enterprise information

5. Please indicate the location (business center) of your enterprise

- Kawangware
- Kibra
- Westlands
- Parklands
- Nairobi CBD
- Starehe
- Dagoretti

Embakasi []

Kilimani []

6. Please indicate sector/industry of your enterprise

Beauty products []

Clothing & fashion []

Mobile phone & accessories []

IT accessories & services []

Crafts and curios []

Financial services []

Real estate []

Automobile []

Salon & barber []

Food & beverage []

Education & technology []

Agribusiness []

Hospitality []

Health []

Trader []

7. Please indicate ownership structure of your enterprise

Company []

Sole proprietorship []

Partnership []

Cooperative []

Others []

Section 3: Entrepreneur Characteristics

8. Please state your opinion on the following statements by ticking the most appropriate response as follows: **1. Strongly disagree 2. Disagree 3. Not sure 4. Agree 5. Strongly agree**

Items	1	2	3	4	5
Experience					
Experience as an entrepreneur in a particular industry, increases chances of acquiring finance					
There is minimal experience required to be successful in loan application					
Experience has nothing to do with issue of finance, as long as other requirements are met					

Education					
The higher the level of education an entrepreneur has attained determines access to debt finance					
Educated entrepreneurs access finance easily because they are aware of the requirements					
The education level of an entrepreneur does not matter in the issue of finance					
Gender					
There is no difference in the willingness to apply for loans between male and female entrepreneurs.					
The banks are biased in the processing of loan applications between male and female-owned enterprises					
Gender has nothing to do with issue of finance once other requirements are met					

Section 4: Firm Characteristics

9. Please state your opinion on the following statements by ticking the most appropriate response as follows: **1. Strongly disagree 2. Disagree 3. Not sure 4. Agree 5. Strongly agree**

Items	1	2	3	4	5
Firm Age					
The duration that a firm has been in existence influences its chances to access debt finance					
The longer a firm has been in operation in an industry does not influence its chances to access debt finance					
The more times an enterprise applies for debt finance the better chance it has of receiving a loan					
Firm Size					
Large number of employees is an indicator that the business is reputable therefore can access finance					
The firm size does not matter at all as long as other requirements are met					
The amount of turnover from a business does not matter in accessing debt finance					
Firm Ownership					
The registration or non-registration status of an SME matters in access to debt finance					
The ownership structure of an enterprise matters in their access to debt finance					
Firm Bank Relationship					
A longer banking relationship increases the chances of an enterprise to access financing					
Multiple bank accounts held in multiple commercial banks increase the chances of an enterprise to access finance					
The length of a banking relationship does not influence the chances of getting finance as long as other requirements are met.					

Section 5: Business Environment

10. Please state your opinion on the following statements by ticking the most appropriate response as follows: **1. Strongly disagree 2. Disagree 3. Not sure 4. Agree 5. Strongly agree**

Items	1	2	3	4	5
Inflation					
The high rate of inflation is a concern when seeking debt finance for my enterprise					
The high rate of inflation increases the costs for seeking debt finance for my enterprise					
The high rate of inflation increases the price of goods and services for my enterprise					
Corruption					
The corruption experienced in the country can determine whether your loan application is approved or rejected by the banks					
The level of corruption in the country contributes to my self-restraint to apply for a loan					
The high levels of corruption impede my enterprise from applying for bank loan					
Tax policy					
The high fees for permits and licenses increase the cost of operating my enterprise and reduce my willingness to borrow.					
The changing tax policies in the country lead to high cost of borrowing through high interest rates					
The high tax rates experienced in the country pose a high risk for my enterprise					

Section 6: Borrower Discouragement

11. In the last 12 months, did you have a need for a loan?

Yes []

No []

12. If yes, did you apply for the loan?

Yes []

No []

13. If no, please state your opinion on the following statements by ticking the most appropriate response as follows: **1. Strongly disagree 2. Disagree 3. Not sure 4. Agree 5. Strongly agree**

Items	1	2	3	4	5
Loan application procedure is too complicated					
Interest rate is too high					
Collateral requirements are too high					
Corruption exists in allocation					
Do not expect to get approved because of my gender					
Do not expect to get approved due to my years of experience					
High taxes make the business environment challenging					



Appendix 2: Ethical Approval



5th April 2024

Ms Kithure Mary,
mary.kithure@strathmore.edu

Dear Ms Kithure,

RE: Factors Contributing to Borrower Discouragement among Micro, Small and Medium Enterprises in Nairobi County, Kenya

This is to inform you that SU-ISERC has reviewed and **approved** your above **SU-masters** research proposal. Your application reference number is **SU-ISERC2118/24**. The approval period is from **5th April 2024 to 4th April 2025**.

This approval is subject to compliance with the following requirements:

- i. Only approved documents including (informed consents, study instruments, MTA) will be used.
- ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-ISERC.
- iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-ISERC within 72 hours of notification.
- iv. Any changes anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-ISERC within 72 hours.
- v. Clearance for the export of biological specimens must be obtained from relevant institutions.
- vi. Submission of a request for renewal of approval at least 60 days prior to the expiry of the approval period. Attach a comprehensive progress report to support the renewal.
- vii. Submission of an executive summary report within 90 days of completion of the study to SU-ISERC.

Before commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology, and Innovation (NACOSTI) <https://research-portal.nacosti.go.ke/> and obtain other clearances needed.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Ambrose Rachier".

**Mr Ambrose Rachier,
Chairperson; SU-ISERC**



Appendix 3: Introductory Letter

Che Sangale Rd, Muthaika Estate,
P.O. Box 59657 00200, Nairobi, Kenya.
Call +254 703 410667, Toll-free 055586994
Email: info@abs.ac.ke or visit: www.abs.strathmore.edu



Tuesday, March 26, 2024

Micro Small Enterprises Authority,
Utalii House, 10th Floor Utalii Lane,
P.O Box 48823 – 00100,
Nairobi, Kenya

Dear Sir/Madam,

RE: FACILITATION OF RESEARCH – KITHURE MARY GAKII

This is to introduce Kithure Mary Gakii who is a Master of Science in Development Finance (MDF) Student at Strathmore University Business School, admission number MDF/31065/19. As part of our MDF Program, Mary is expected to do applied research and undertake a project. This is in partial fulfilment of the requirements of the MDF course.

Mary is undertaking a research paper on "Factors Affecting Borrower Discouragement among Micro Small and Medium Enterprises in Nairobi County". The information obtained shall be treated confidentially and shall be used for academic purposes only.

Our MDF seeks to establish links with industry, and one of these ways is by directing our research to areas that would be of direct use to industry. We would be glad to share our findings with you after the research.

We appreciate your support and shall be willing to provide any further information if required.

Yours sincerely,

A handwritten signature in blue ink, appearing to be "Alois Njenga". The signature is stylized with a large initial 'A' and a long horizontal stroke.

Alois Njenga,
Manager - Graduate Programs.



Appendix 4: Research Permit

 REPUBLIC OF KENYA	 NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION
Ref No: 553525	Date of Issue: 19/April/2024
RESEARCH LICENSE	
	
<p>This is to Certify that Miss. Mary Gakli Kithure of Strathmore University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Nairobi on the topic: Factors contributing to borrower discouragement among micro,small and medium enterprises in Nairobi county Kenya for the period ending : 19/April/2025.</p>	
License No: NACOSTI/P/24/34808	
553525 Applicant Identification Number	 Director General NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION
	Verification QR Code 
<p>NOTE: This is a computer generated License. To verify the authenticity of this document, Scan the QR Code using QR scanner application.</p>	
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