THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

Financing Cost Effect on Financial Performance of Micro and Small Enterprises in Starehe, Nairobi City County, Kenya

John Mwangi Ngureh
Part time Lecturer, Department of Accounting and Finance, Kenyatta University, Kenya
Dr. Eddie Simiyu Mungami
Lecturer, Department of Accounting and Finance, Kenyatta University, Kenya
Dr. Mungami John Njangiru
Lecturer, Department of Accounting and Finance, Kenyatta University, Kenya

Abstract:
Micro and Small Enterprise immensely contribute to economic development around the world, in Africa and also in Kenya. Micro and Small Enterprises play a significant role in creation of employment, income generation and are seedbed for medium and large enterprises. Micro and Small Enterprises face many challenges limiting their financial performance and survival as measured by return on assets and growth in sales, including lack of markets, competition, lack of skilled manpower, and poor management practices. In Kenya, Micro and Small Enterprises failure rate is 67%. In Nairobi City County Micro and Small Enterprises financial economic performance measured by growth in sales declined from 95.7% in 2011 to 87.2% in 2017. This study investigated the effect of financing costs on financial performance of Micro and Small enterprises in Starehe, Nairobi City County, Kenya. The study was anchored on Trade-off theory, Pecking-Order theory and financial constraint theory to give direction and support to this paper. The study adopted positivism research philosophy and a descriptive survey design. The study used stratified random sampling to select 384 Micro and Small Enterprises determined from a target population of 21,869 Licensed by Nairobi City County. Primary data (cross sectional) were used in the paper, and was collected by administering a questionnaire with closed end-ended questions, with a rating scale of 1-5. Confirmatory Factor Analysis was used to ascertain the validity of the measurement model before commencing Structural Equation Modeling to test the hypotheses under study through Amos software. Data was analyzed using descriptive statistics (mean, frequency distribution standard deviation) and inferential statistics (Multivariate analysis-Structural Equation Modeling). Diagnostic tests included Keizer-meyer-olkin test, Berletts test of sperecity, Normality test and Multi-collinearity test. Data results were presented inform of tables, graphs, charts and percentages. The study found that there was a positive and significant relationship between financing costs and financial performance of Micro and Small Enterprises. The study recommended that the government through its financial agencies work out a framework to reduce costs to Micro and Small Enterprises. Secondly, the study recommended that the government should reduce the bureaucracy involved in business start-ups. Thirdly, the government should enhance entrepreneurship skills to Micro and Small Enterprise owners and managers.

Keywords: Collateral, financing costs, financing decisions, micro-enterprises, micro and small enterprises

1. Background to the Study

In low and middle income countries, Micro and Small Enterprises (MSEs) serve as drivers of economic growth (Otengo, 2016). By advantage of their size, basic investment and their capacity to create jobs, active MSEs, have proved their ability to accelerate economic growth. According to International Labor Organization (2016), access to capital for investment has been a major impediment to performance of MSEs and will continue to constrain business financial performance.

Kenya National Bureau of Statistics (KNBS) Economic survey (2017) stated that MSEs in Kenya face many challenges which affect their financial performance resulting in decline in return on assets and sales volume. Society for Economic Development Report (2016) notes that, the cost of accessing finance inhibits financial performance of MSE sector. Kenya National Bureau of Statistics Survey (2017) indicated that many MSEs in Kenya barely survive past their third year of operation. Many of those that continue to operate become dormant at the small level and do not develop into medium level or even large businesses. Financial cost of funds and improper management are cited as key reasons for closure and stagnation of MSEs.

According to Kenya economic survey (2017), MSEs in Starehe Sub-County (SBC), financial performance measured by growth in sales was, in 2011 (95.7%), 2012 (95.4%), 2013 (88.7.7%), 2014 (87.7%), 2015 (87.3), and declined to 2016 (87.2%). These ratios show a gradual decline in financial performance of MSEs in Starehe sub-County. Accordingly to this

survey, financial performance of SBC in MSEs is anemic as indicated by decrease in their growth rate from 5.4% in 2015 to 4.3% in 2016.

There have been various government and private sector initiatives to improve access to finance for MSEs. Central Bank of Kenya (2017) report indicates that, banking sector reforms taken in 1991 through Banking Financial Act of 1991, liberalized banking services and therefore expanded financial services to MSEs. Satta (2013) stipulated the removal of regulations in lending and investment institutions in Kenya. Mabhungu, Masambe, Mhazo, Jaravaza, and Chriser (2011) found that firm's level characteristics, value of assets, business sector, age of the firm and firm's size, as important determinants on MSE access to finance. Lenders tend to give loan facilities to firms which have established relationship with them and those which provide collateral. According to Richard (2010) interest rates, loan period and credit limit determine the amount of late payment penalty, discount of cash or early payment, maximum time allowed for payment and monthly total credit amount.

Goverment of Kenya (2016) vision 2030, strategised to deliver 10% annual growth from 2012 by transforming Kenya's current level of economic performance by improving financial services to small businesses and encouraging more entrepreneurship risk taking activities. Savings is expected to rise from 17% to 30% of Gross Domestic Product by increasing bank deposits from 44% to 80% of borrowed capital. The Goverment will decrease the proportion of population without access to finance from 85% to below 70% through MSE development by the year 2030.

1.1. Financing Preference Determinant-Financing costs

Mabhungu *et al.,* (2011) stated that, MSEs financial performance factors include operating period, value of assets, size and operating period. Financial institutions are likely to give loans to borrowers with collaterals but not otherwise. Martin and Daniel (2013) found that, the firm's age play a role in firm's financing. Older firms were found to access more finance than younger ones. Abor (2013) found that, short-term credit is used more in retail sectors and wholesale compared to manufacturing firms, whereas hotels, mining, construction, and hotel industries tended to use more long-term finance.

Ngugi (2012) indicated that, interest rates, credit limit, early repayment discount and late repayment penalty are some of credit terms under which credit is granted. Rate of interest is a key determinant in financing, as it influences investment. Kabede and Abera (2014), stipulated that, with a high interest rate on saving, more deposits will be made and banks will be attracted to approve more loans but investors will apply less volume of loans when interest rates go up.

1.2. Financial Performance of Micro and Small Enterprises

According to Ndede (2015), how well a MSE uses assets of the business to generate revenue is a rod of measuring its financial performance. Financial Performance is described by Ndede (2015) as an activity or accomplishment considered in relation to how successful it is and is related to volume of sales for a given capacity of business. Financial performance is measured and observed overtime in the organization (Mohan & Mohamed 2012). According to Ndede (2015), it can be observed that good financial performance has the same meaning as business financial success.

Chelmata *et al.*, (2012) stipulated several different approaches of MSE financial measures. Firstly the goal approach which directs owners of business to focus their attention financial measures like Return on Investment, Return on Sales, profits, revenues, Return on Equity. Secondly, organic approach which focuses on the needs of shareholders as expressed in the concept of sustainable development. Thirdly, strategy alignment and developnet approach whic focus on Micro and Small Enterprises business strategy (aims, fuctions, operational aspects) and assesment of appropriateness of the strategy to reach planned goals. Fourthly, balance approach which focus on both financial and non financial measures. Fifthly, Process orientation approach which focuses on Micro and Small Enterprise processes impact on its added value and support on decision making processes. Lastly, perfomance measurement system (IRIS) which alllows continous improvement of the system by taking the results of the application, and adaption to changing environment and company's strategy revisions.

Schayek (2011) asserted that, financial performance of a firm may be measured using operational or objective measures. Financial performance measures are key financial performance indicators, hence they are derived from a firms financial statements. Ahamad (2014) investigated 160 small businesses in Malasia affirmed that the most commonly used financial perforformance measures include sales growth, operating income, cashflow measure and return on investment. Garrigos, Galdon, and Gil (2015) also categorised financial performance measurement into four, namely: Profit which include, return on investment, return on sales; return on assets; wealth creation; market share, growth in term of sales, and stakeholder satisfaction which include employees satisfaction, customer satisfactionand competitive position which include overall competitive position and success rate in launching new product. The research study investigated competitive strategies and performance in Spanish hospitality firms. This study used level of profit and growth in sales to measure MSEs financial performance.

1.3. Statement of the Problem

Kenya National Bureau of Statistics (KNBS) (2017) indicated that many MSEs in Kenya have poor business financial performance as some of them stagnate, others close down and never develop to the Medium and large stage of business development because of low return on investment caused by high financing costs. According to Kenya National Bureau of Statistics (2017), 46.3% of MSEs close within one year of opening, 15% close within two years, 9.5% close within three years, 5.3% close within four years, 3.9% close within five years, 11.2% close between 6-10 years, 3.9% close between 11-15 years, while those closing after fifteen years of operation are 4.9% because of decline of return on assets and low sales volumes. When MSEs close, there is loss of employment and reduced contribution to economic growth.

National MSEs survey (2016) indicated that MSEs in Kenya face many obstacles which limit their financial performance and survival. National MSEs survey (2016) indicates MSEs failure rate as 67% occuring due to shortage of operating funds (29.6%), personal reasons (22.9%), too few customers (15.3%), shortage of stock (6.2%), too many competitors (4.5%), legal problems/goverment regulations (3.3%), theft or insecurity (3.2%), sickness (3.2%), huge business debts (2.8%), and starting another business/branch (2.1%).

Financial performance of Micro and Small Enterprises is dependent on financing costs. Several studies have investigated to some extent these Financing costs. For instance, Mugo (2012) and Mburu (2012). Previous studies (Mugo 2012, Mburu 2012, Mbugua et al., 2014, and Ssekajudo 2015) reviewed did not capture financing costs and fixed assets owned variables influenncing financial performance of a business. All these studies on performance of small businesses indicate that there is a knowledge gap. Unlike previous studies reviewed this research uses SEM to analyze data. SEM is covariance based allowing quality in measurement variables as measurement errois not aggregated in residual error (Hair, 2012).

1.4. Objective of the Study

The specific objective of the study is to examine the effect of financing costs on financial performance of Micro and Small Enterprises in Starehe Nairobi City County, Kenya.

2. Literature Review

2.1. Theoretical Review

The theories reviewed in this section include, trade-off theory, pecking order theory, entrepreneurial theories resource based theory and financial constraint theory.

2.1.1. Trade-off Theory

This approach proposed by Kraus and Litzenberger (1973) stipulated that, capital structure is generally composed of debt and part equity. According to this theory, the advantage of financing with debt, for example, tax benefits of debt are balanced off against costs of financing with debt like bankruptcy and payment terms. The entrepreneur chooses how much debt finance and how much equity finance to use by balancing costs and benefits. Lean and Tucker (2001) argue that a finance gap exists for small firms owing to their disadvantaged position in the market of bank finance which is caused by information asymmetry that exists between the provider and the recipient of finance. This problem has intensified in recent years by centralization of bank lending decisions and the introduction of computerized credit scoring.

2.2.2. Pecking Order Theory

The pecking order theory by Myers (1984) proposed that financing is continuous starting with the cheapest source to the most expensive, hence firms and individuals use personal funds before acquiring external debt. The financing costs influence the decision of MSE owners to finance their business activities in a certain order, that is, use of internal sources followed by debt. According to this approach, a firm chooses from source of finance that reduces the price of investment (Baker & Wurgler, 2007). The small business will utilize own funds first before accepting external funds (Dittmar & Thakor, 2007).

2.2.3. Financial Constraint Theory

This theory proposed by Evans and Javanovic (1989) stipulated the relationship between individual wealth and entrepreneurship. According to Evans and Javanovic (1989), idividuals with adquate financing capital are more able to effectively exploit entrepreneurial opportunity. Financial Capital Liquidity theory (Alvarez & Busen'tz, 2001) fosters financial constraint theory as predictor of opportunity based entrepreneurship. Access to financial and human assets enhances an enterpreneurs ability to detect opportunities and act upon them (Davidson & Honning 2003).

2.3. Empirical Review

Mugo (2012) investigated the factors affecting women entrepreneurs' performance in Kenya and cited lack of access to credit as the biggest challenge that affect financial performance and growth of Micro and Small Enterprises. The cause of access to credit is the business inability to raise adequate finance internally or through debt financing because of high interest rates.

Wanjohi and Mugure (2008) investigated the factors affecting Micro and Small Enterprises in rural areas in Kenya, and found that, lack of long-term credit, influences them to depend on short-term credit which is very costly and has negative impact on their growth and financial performance. If external financing is used, then administrative costs and interest costs have to be paid. Mwania (2011), investigated the effect of Biashara Boresha loan on performance of MSEs owned by Kenya Commercial Bank Ruiru Branch customers, found that the effect of capital financing on the financial performance of MSEs in Kenya improves their credit rating, marketing and distribution networks.

2.5. Conceptual Framework
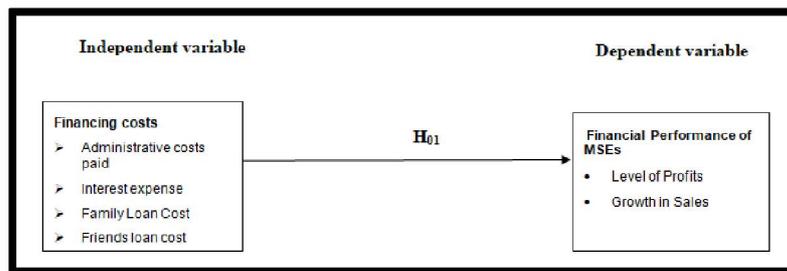
Figure 1: Conceptual Framework
Source: Researcher, 2018

3. Research Methodology

3.1. Research Philosophy

Positivism research methodology was adopted in this research, which is an approach to the study of society that relies specifically on scientific evidence such as statistics to reveal the true nature of how the society operates (Saunders, Lewis & Thornhill, 2009). The authors indicate that, positivism is adopted when working with observable social realities which can be generalized. Accordingly, the hypotheses were tested, then rejected or not rejected.

3.2. Research Design

The design adopted by the study is descriptive survey research design. According to Cooper and Schindler, (2008) descriptive survey design is used because it explores relationships between variables, it ensures complete description of the current status of the phenomenon under study, ensures minimum bias in data collection. It also allows data collection from population in an economical way. Luvai and Maende (2014) stated that, the variables of interest in descriptive survey research design cannot be manipulated as in experimental research, and ensures that the environment remains the same when data is being collected. According to Kothari (2004), descriptive survey research design is used when the problem has been well designed. According to Mugenda and Mugenda (2003) and Saunders, Lewis and Thornhill, (2007), there is no single approach that exists in isolation and hence different approaches should be mixed and matched to achieve optimal results.

3.3. Empirical Model

The study utilized Structural Equation Modeling (SEM), a prediction, covariance-based Model to test the hypotheses under study through AMOS software advocated by (Byne, 2001). The predictive power of the predictor variables, are tested from the following hypothesized general model in Structural Equation Modeling language;

SEM $(X_1 \leftarrow Y)$ $(X_2 \leftarrow Y)$ $(X_3 \leftarrow Y)$ $(X_4 \leftarrow Y)$ (M_1/X_iY)...................... (3.4)

Where $(X_i \leftarrow Y)$ Means that X_i affects Y. (M_1/X_iY) Means M_1 mediates X_i and Y.

To examine the influence of Financing Preference Determinants on financial performance of Micro and Small Enterprises, the study formulated equations 3.4.1, 3.4.2, and 3.4.3., (Fairchild & MacKinnon, 2009).

Where i. $Y = C + B_1 X_1 + e.$ .... (3.4.1)
ii. $Y = C + B_1 X_1 + B_2 X_2 + e.$ .... (3.4.2)
iii. $Y = C + B_1 X_1 + B_2 X_2 + B_3 X_3 + e.$ .... (3.4.3)

The moderation effect of regulatory framework on the association of Financing Preference Determinants on performance of Micro and Small Enterprises was established by the study formulating equation 3.4.4., (Fairchild & MacKinnon, 2009). This study used the best method available in SEM to test interaction known as orthogonalizing method (Hensler & Chin, 2010).

iv. $Y = C + B_1 X_1 + B_2 X_2 + B_4 X_4 + B_5 X_1 X_4 + B_6 X_2 X_4 + e$ ...... (3.4.4)

The mediation influence of Risk Taking on the association of Financing Preference Determinants and financial performance of MSEs was established by the study formulating equations 3.4.5 and 3.4.6., (Fairchild & Mackinnon, 2009).

V. i. $M = C + B_8 X_1 + e$ ii. $Y = C + B_9 M + e.$ iii. $Y = C + B_{10} X_1 + B_{11} M + e$ ... (3.4.5)
Vi. i. $M = C + B_{12} X_2 + e$ ii. $Y = C + B_{13} M + e.$ iii. $Y = C + B_{14} X_2 + B_{15} M + e.$... (3.4.6)

Where Y is Financial Performance
C = Constant, X_1 = Financing Costs, X_2 = Ownership Characteristics,
X_3 = Firm's Characteristics, X_4 = Regulatory Framework (Moderator)
M = Risk Taking (Mediator), B_i = Path Coefficient (coefficient of beta), e is error term.

3.4. Study Locale

This study was conducted in Starehe Sub-County of Nairobi City County (NCC). Starehe Sub-County is one of the twelve Sub-counties that make Nairobi City County (NCC, 2018). Starehe Sub-County has six administrative wards, namely; Kariokor, Nairobi central, Nairobi South, Ngara, Land Mawe, and Pangani wards. Starehe sub-county provides a variety of Micro and Small Enterprises and was an ideal location for this type of research.

3.5. Target Population

The target population of the study was 21,869 Licensed MSEs in Starehe Sub-county by Nairobi City County (KNBS, 2016). The Micro and Small Enterprises were clustered into seven economic zones, namely; Trade, Transport Telecommunications and Storage, Catering, Professional and Technical Services, Education, Health and Entertainment, and Manufacturing. Table 1 presented the population per business sector.

Sector	No of MSEs	Weighted Percentage
Trade	13,209	60.4%
Transport, Telecommunications and storage	1,312	6%
Agri-businesses, Forestry and Natural resources	66	0.3%
Catering	1,596	7.3%
Professional and Technical services	3,936	18%
Education, Health and entertainment	439	2%
Manufacturing	1,312	6%
Total	21,869	100%

Table 1: Target Population Starehe Sub-County
Source: KNBS (2017)

3.6. Sampling Design

The Micro and Small Enterprises were clustered into six economic zones, namely; Trade; Transport Telecommunications and storage; Agri-business, Forestry and Natural resources; Professional and Technical services; Education, Health and Entertainment; and Manufacturing. Stratified random sampling technique was used to arrive at the number of respondents in each of the six economic zones (Table 1). The sample size was determined using formula of determining representative sample in large proportions sample Cochran (1963). The Cochran's formula is appropriate with large populations of more than 10,000 objects.

n = Z.Z * P (1-P) / d.d……………………………………………………… (3.7.1)
Where n is the desired sample size.

    Z is the standard normal deviate set at 1.96 for 95% confidence level.

    P is the percentage of picking a choice in target population expressed as a decimal of 0.5 used for sample size needed.

Where d is the level of statistical significance (degree of accuracy required) set at 0.05

Hence, n = (1.96) (1.96) (0.5) (1-0.5)/ (0.05) (0.05) = 384 Micro and Small Enterprises.

Table 2 shows stratified random sampling technique to pick respondents per sector.

Sector	No of MSEs	Sampling Rate = (MSEs/Total)100%	Sampling Rate * 384 = Sector Size
Trade	13,209	60.4%	232
Transport, Telecommunications & Storage	1,312	6%	23
Agri-businesses Forestry & Natural resources	66	0.3%	1
Catering	1,596	7.3%	28
Professional and Technical services	3,936	18%	69
Education Health & Entertainment	439	2%	8
Manufacturing	1,311	6%	23
TOTAL	21,869	100%	384

Table 2: Sampling Frame
Source; Researcher, (2018)

3.7. Data Collection Instrument

The data was gathered through structured questionnaires. Heize, (2009), stated that, a questionnaire is a research apparatus consisting of a series of questions and added prompts for the purpose of gathering data from respondents. The questionnaire is semi-structured for qualitative and quantitative data respectively. Structured Questionnaire was preferred as data was gathered in a consistent manner, making them more impartial than interviews; data was collected very fast and from a large proportion of a set (Mugenda & Mugenda, 2003).

4. Research Findings and Discussions

4.1. Descrptive Statistics Findings of the Study

Table 3 shows descriptive statistics results for financing costs.

Variables	N-statistic	Mean	Standard deviation
Family loan amount	303	1.53	.556
Family loan cost	303	1.61	.570
Bank loan amount	303	1.88	.687
Bank loan administrative cost	303	1.83	.649
Bank loan interest per year	303	1.80	.573
Loan from friends amount	303	1.64	.538
Loan from friends cost	303	1.70	.508
Loan from Sacco amount	303	1.65	.573
Loan from Sacco administrative cost	303	1.69	.523
Loan from Sacco interest per year	303	1.62	.608

Table 3: Financing Costs and Financial Performance
Source: Survey Data 2019

On the basis of table 4.4 the larger part of respondents with (mean score = 1.88) indicated that their initial capital is from banks and hence their major concern are administrative costs (mean score = 1.83) with interest per year (mean score = 1.80) being capped by the government. The results show that the use of Sacco loan (mean score = 1.69) as initial capital follow the bank loan with their major concern being administrative costs (mean score =1.69) followed by the interest per year (means sore = 1.62). The use and influence of friends loan (mean score = 1.64) follows use of Sacco loan. The use and influence of family loan amount with a mean score of 1.53 is last in the four variables. Table 4 presents the amount of initial capital and the respective source (Family, Bank, Friends or Sacco).

	Family	Bank	Friends	Sacco
Below 50000	50%	30%	39%	40%
50000-200000	48%	52%	58%	55%
Above 200000	3%	18%	3%	5%

Table 4: Initial capital and Source
Source: Survey data 2019

Table 4 indicates that the amount of initial capital of most respondents was between Ksh 50000 and Ksh200000 from friends (58%), Sacco (55%) and Banks (52%). Those respondents with an initial capital of above Ksh 200000 were quite few with highest source from the Bank (18%), followed by Sacco (5%), and followed by friends (3%) and family (3%). Table 5 presents family loan costs, bank loan costs, friend's loan costs and Sacco loan costs (percentages).

	Family	Bank Adm.	Bank Interest	Friends	Sacco Adm.	Sacco Interest
NIL	2%	0%		0%	1%	0%
1-15000	44%	31%	28%	33%	34%	45%
15001-60000	52%	55%	63%	65%	63%	49%
Above 60000	0%	14%	8.3%	2.3%	3%	7%
Total	100%	100%	100%	100%	100%	

Table 5: Loan Facility Costs
Source: Survey Data 2019

Results in Table 5 indicate that the larger part of respondents with loan facility was in the range ksh 15001-60000. Those respondents who indicated that the loan cost was above ksh 60000 were quite few. The respondents who indicated the loan facility cost was between ksh 1 to ksh 15001 were family (44%), bank (administrative 31%, Interest 28%) friends (33%) and Sacco (administrative 34% Interest 45%). The respondents who indicated that the loan cost was between ksh 15001 to ksh 60000 was family (52%), Bank (administrative 55% interest 63%), friends (65%), Sacco (Administrative 63% Interest 49%). From the table most respondents indicated that they obtained loan facility from the bank because the interest had been capped.

4.3. Financial Performance

The respondents were requested to indicate the level of MSEs profit for the years (2014, 2015, 2016, 2017), the value of the business in 2017, the amount of capital invested in 2017 and also the level of the sales (2014, 2015, 2016, 2017). The results are indicated in Table 6.

Variable	N	Mean	Standard Deviation
Indicate level of your MSE business profit in 2014	303	1.63	.682
Indicate level of your MSE business profit in 2015	303	2.08	.833
Indicate level of your MSE business profit in 2016	303	2.37	.910
Indicate level of your MSE business profit in 2017	303	2.50	.996
What is value of your assets in 2017	303	1.86	.727
What is your capital invested in 2017	303	2.08	.881
Indicate your total sales in 2014	303	2.01	.935
Indicate your total sales in 2015	303	2.16	.781
Indicate your total sales in 2016	303	2.50	.845
Indicate your total sales in 2017	303	2.69	.943

Table 6: Descriptive Statistics for Financial Performance
Source: Survey Data 2019

On the basis of Table 6 the larger part of respondents with a mean score of 2.50 indicated the highest level of profits was in 2017 as the mean score is 2.50 followed by the level of profits in 2016 as the mean score is 2.37. From Table 6 the larger part of the respondents indicated that the level of sales is highest in 2017 as their mean score is 2.69 and the level of sales in 2016 is second with a mean score of 2.50. The best financial performance was recorded in 2017 as indicated from statistics in Table 7. Table 7 presents financial performance indicators (profit and sales) for the years 2014 to 2017 in percentages.

KSH	2014p	2015p	2016p	2017p	2014s	2015s	2016s	2017s
0-50000	47%	29%	22%	22%	40%	18%	10%	8%
500001-100000	43%	34%	28%	20%	24%	54%	42%	40%
100001-200000	9%	36%	42%	43%	33%	23%	35%	27%
Over 200001	1%	1%	8%	16%	4%	6%	13%	25%
Total	100	100	100	100	100	100	100	100

Table 7: Financial Performance Indicators 2014 to 2017 in Percentages
Source: Survey Data 2019

Table 7 indicated that 43% of the respondents recorded profit between Ksh100001-20000 in 2017 and 16% of the respondents recorded profit over Ksh 20000 in the same year of 2017. In 2014, most businesses recorded low profits. Table 7 indicated that 54% of the respondents reorded sales of between Ksh 50001-100000 in 2015 and 40% of the respondents recorded sales of between Ksh 50001-100000 in 2017. In the year 2017, 25% of the respondents recorded sales above Ksh 20000. The statistics in Table 7 indicates that the best financial performance was recored in 2017.

4.4. Confirmatory Factor Analysis Measurement Model

This measurement model is based on conceptual framework. It consists of 2 constructs, namely; financing costs (FC) and financial performance (FP) as shown in table 4.8.

Latent constructs	Number of items	Code name/parcel
Financing costs (FC)	10	q3
Financial performance (FP)	10	q30, q31, q32, & q33

Table 8: Latent Constructs and Items/ Parcels Used in the Analysis
Source: Survey Data 2019

From table 8 Financing Costs had 10 observed variables, namely, family loan amount, family loan cost, bank loan amount, bank loan administrative costs, bank loan interest per year, loan from friends amount, friends loan cost, loan from sacco amount loan fron sacco administrative costs and sacco loan interest per year.

Financial Performance had 10 observed variables, namely, the business profit for the year 2014, business profit for the year 2015, the level of business profit in 2016, the level of business profit in 2017, what is the value of your assets now?, what is your total capital invested now?, what is your total business in 2014?, what is your total business sales in 2015, what was you total business sales in 2015? and what was your total business sales in 2017? These obseved variables are presented in Figure 2. According to Byrne (2013), the proposed initial measurement model should be modified to fit the data. Hence, further analysis of the latent variables was conducted using one factor congeneric model.

4.5. One Factor Congeneric Model Results

According to Cunningham (2008), one factor congeneric model examination is used by decomposing the full measurement into a number of measurement models or multi-factor models based on each latent construct (Kline, 2011). Modification of proposed measurement models are discussed in sections 4.6.1 and 4.6.2

4.6.1. Examination of One Factor Congeneric Feasurement Model for (FC)

The latent variable subjected to one factor congeneric measurement was financing costs as suggested in Figure 2 and table 4.8. The latent variable financing costs was loaded with ten observable variables namely, q3ia, q3ic, q3iia, q3iib, q3iie, q3iiia, q3iiid, q3iva, q3ivb, q3ive and each variable associated with measurement error. The reommended threshold for factor loading was 0.6 though with a data with over 200 observed variables 0.5 would be acceptable (Byrne, 2013).
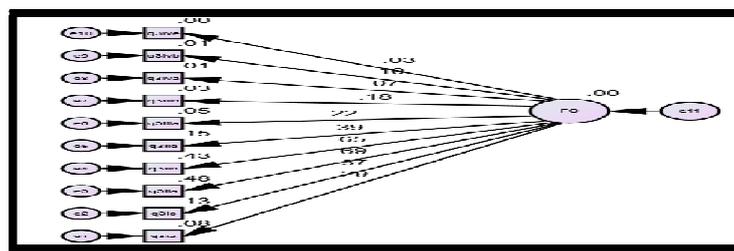
Figure 2: Estimated Initial One-Factor Congeneric Measurement Model for
Financing Costs with Factor Loadings Shown There off
Source: Survey Data 2017

Table 12 shows goodness of fit indexes for the one factor congeneric model for financing costs.

Category	Index name	Value	Comment
Absolute fit	Chi-square	285.447	Required level achieved
	RMSEA	0.133	Required level not achieved
Incremental fit	RFI	0.452	Required level not achieved
	NFI	1.0	Required level achieved
	CFI	1.0	-DO-
Parsimonious fit	Chis/do	6.643	Required level not achieved

Table 9: Goodness of Fit Indexes for the One Factor Congeneric Model (FC)
Source: Survey Data 2019

On the basis of Table 9 the values for all fitness indexes do not achieve the required level of acceptance and hence the proposed model does not fit the data. To achieve fitness indexes, modification was carried out in the model by deleting all items with a factor loading of less than 0.6. The goodness of fit indexes for the modified model of financing costs were presented in Table 10.

Category	Index name	Value	Comment
Absolute fit	Chi-square	0.0	Required level achieved
	RMSEA	0.518	Required level achieved
Incremental fit	RFI	1.0	Required level achieved
	NFI	1.0	Required level achieved
	CFI	0.0	-DO-
Parsimonious fit	Chis/df	0.0	Required level achieved

Table 10: Goodness of Fit Indexes for the New FC Modified Model
Source: Survey Data 2019

Table 10 shows goodness of fit values indicate a solid evidence of unidimensionality, convergent validity and reliability.

4.6.2. Examination of One Factor Congeneric Model for Financial Performance

The congeneric measurement model examined was for financial performance as latent variable. The unobserved variable FP was loaded with ten observable variable, namely; Q30a, q30b, q30c, q30d, q31, q32, q33a, q33b, q33c q33d, each variable is associated with measurement error. The results are presented in Figure 3.
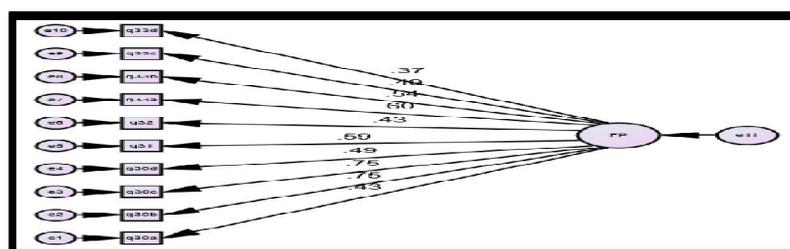
Figure 3: Estimated Initial Congeneric Measurement Model for Financial Performances with
Factor Loadings Shown Thereof
Source: Survey Data 2017

To indicate whether the model fits the data, the goodness of fitness indexes were considered. Table 11 presents the goodness of fit indexes for financial performance (FP) congeneric model.

Category	Index Name	Index value	Comment
Absolute Fit	Chi-square	436.243	Required level achieved
	RMSEA	0.195	Require level not achieved
Incremental Fit	RFI	0.483	Required level not achieved
	NFI	1.00	Required level achieved
Parsimonious Fit	Chisq/df	12.464	Required level not achieved

Table 11: Goodness of Fit Indexes for Financial Performance Congeneric Model
Source: Survey Data

Table 11 shows that not all fitness indexes have achieved the required level of acceptance and hence the proposed model does not fit the data. To achieve the fitness indexes, modification was carried out in the model by deleting all items with a factor loading less than 0.6. Table 12 shows the goodness of fit indexes for the new model.

Category	Index Name	Index value	Comment
Absolute Fit	Chi-square	0.1	Required level achieved
	RMSEA	0.0	Require level achieved
Incremental Fit	RFI	1.0	Required level achieved
	NFI	1.0	Required level achieved
	TLI	1.0	
Parsimonious Fit	Chisq/df	0.064	Required level achieved

Table 12: Goodness of Fit Indexes for New Modified FP Congeneric Model
Source: Survey Data 2019

Table 12 shows the fitness indexes values shows a solid evidence of unidimensionality, convergent validity and reliability. The model is ready for Structural Equation Modeling.

4.7. Structural Equation Model Results for Financing Costs

The Amos output for financial costs on financial performance is shown on Table 13. This is a direct relationship. When there is a change in one variable, there is also likely to have a corresponding change in the other variable.

Relationship	S.E	Beta value	Critical ratio	P-value
FC ------→FP	0.136	0.54	5.335	0.001

Table 13: Amos Output for Direct Relationships
Source: Survey Data 2019

The objective of this study was to access effect of financing cost on financial performances of MSEs in Starehe. The financial costs studied in this research included administration cost, interest expense, family loan cost and friends loan cost. The beta value for the path from Financing Costs to Financial Performance is 0.54. The most important test in hypothesis testing is the critical ratio or the t- value (markus, 2012). If the p-value is less than or equal to 0.05 (≤0.05) and CR is over +/- 1.96, the association is considered significant. Figure 4 presents the path coefficient for financing cost direct relationship.
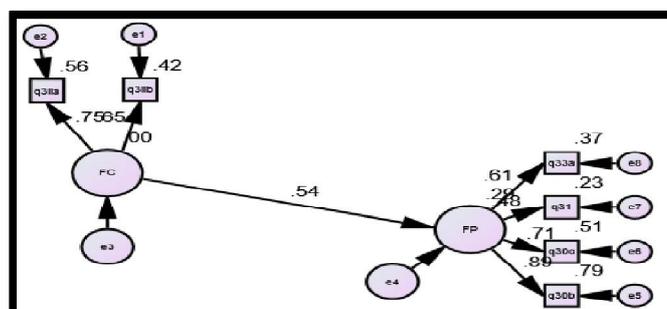
Figure 4: Path Coefficient for Financing Cost Direct Relationship
Source: Survey Data 2017

The null hypothesis stated that financing costs have no significant effect on financial performance of MSEs in Starehe, Nairobi City County, Kenya. Results in Table 13 indicate that the probability of getting a critical ratio of 5.535 in absolute value is less than 0.001. Thus, the regression weight for financing costs in prediction of performance of MSEs is

significantly different at 0.001 level (two-tailed). The study result demonstrated a positive and significant path from financing costs to financial performance. (B=0.54, t –Value = 5.60, P=0.001 (P<0.05). The null hypothesis was rejected. The coefficient value of financial cost had a positive statistical value which implies that financing cost positively influences the financial performance of MSEs. In other words, the beta coefficient for the effect financing costs on financial performance of Micro and Small Enterprises of 0.52 means that for every unit increase in financial costs the financial performance increased by 0.52. This study found that Micro and Small Enterprises with high loan facilities (more than Ksh 200000) depended on banks (mean score of 1.88) because the interest rates were controlled. Those MSEs requiring moderate finance (between Ksh 15001-60000) depended on friends loan (mean score 1.70) whose cost was relatively low. The result of this study is consistent with prior researchers, findings (Mugo 2012, Emmanuel *et. al.,* 2014, Mwania 2011, Mugure 2008) which indicate that finance costs have significant effect on financial performance.

5. Recommendations of the Study

The government should try to reduce financing costs of doing a business. This study found a positive significant influence of financial costs on financial performance of a MSE. Hence, this study recommends that the government through its financial agencies like MSE authority to work out a framework to reduce financial costs to MSEs. This will enable MSE to operate profitably which will enhance economic growth and also sustain development.

The Kenya government and Central Bank of Kenya launched MSE loan product with five Commercial Banks; Commercial Bank of Africa, the Co-operative Bank of Kenya, Commercial Bank of Kenya limited and NIC Group PLC. The product is a mobile based credit product for MSEs known as Stawi. Currently it is pilot based (Thirty thousand traders) and interested parties can now access between thirty thousand shillings and two hundred fifty thousand shillings, the repayment period is between one month and twelve months at an interest rate of nine per cent yearly accompanied by a facility fee four per cent, a 0.7 percent insurance fee based on the disbursed amount and an excise duty that is twenty percent of facility fee.

The costs of starting a business are still high for most entrepreneurs' in spite of government involvement in this area. This study recommends that the government reduce the bureaucracy involved in business start-ups. These will in turn reduce business start-up costs. This will increase the number of people starting the business which will reduce unemployment among the youth and the wider population.

6. References

i. Ahmad, K. (2014). *The Adoption of Management Accounting Practices in Malaysian   SMEs.* Unpublished doctor of philosophy thesis, Exeter, University of   Exeter.

ii. Byne, B. (2001). *Structural Equation Modeling with AMOS: Basic concepts, Applications and Programming.* Manwah, NY: Lawrence Elbaum Associates, Publishers...

iii. Cooper, D., & Schindler, P. (2008). *Business Research Methods*. (8th Ed.). New Delhi, McGraw hill, Bulletin.

iv. Garrigos, F., Galdon, J., & Gil, L., (2015). *The economic sustainability of tourism growth leakage calculation*. Tourism economics, 21(4), 721-739.

v. Hair, J. (2012). *Multivariate data analysis.* Macmillan Publishing Company New York

vi. Hair, J. & Sarstedt, M., (2014). *A primer on partial least squares SEM (PLS-SEM).* Sage publications California.

vii. Hair, J., Black, W., & Babin B. (2014). *Multivariate Data Analysis: A Global Perspective.* Upper Saddle River, New Jersey, Pearson Prentice Hall.

viii. Irwin, D., & Scoot. J. (2010). *Barriers faced by SMEs in raising Bank Finance*. International Journal of Entrepreneurial Behavior and Research. 16(3), 245-259.

ix. KNBS (2017). *Economic Survey (2016) Highlights*. Kenya Bureau of Statistics   Nairobi.

x. Kline, R. (2011). Principles of practice of structural equation modeling. New York, the Guilford Press.

xi. Lean, J., & Tucker, J., (2001). Information asymmetry, small firm finance and the role of government. Journal of finance and management in public services. Volume 1, 2001.

xii. Mabhungu I., Masamba B., Mhazo S., Jaravaza D., & Chiriseri L.,(2011). *Factors influencing MSEs access to finance since the adoption of multicurrency system in Zimbabwe*. Journal of Business management in economics.

xiii. Martin M. & Daniel K. (2013). *Does Firm Profile Influence Financial Access of SMEs in Kenya?* Asian and Economic Review. 3(6): 714-723

xiv. Mohan S., & Muhammed M. (2012). *Financial Preferences of investment decisions in Micro and Small Medium enterprises, India.*

xv. Mugenda, O. and Mugenda, A., (2003). *Research Methods*: *Quantitative and. Qualitative Approaches*. Nairobi: Acts Press.

xvi. Myers, S. (1984). *The Capital Structure Puzzle*. Journal of Finance. Vol. 34 No.3 pp575-592

xvii. Myers, S. & Majluf, N. (1984). *Corporate Financing and Investment decisions when firms have information that investors do not have*. Journal of financial economics, 13(2), 187-221.

xviii. Ngugi, P. (2012). *Challenges hindering sustainability of small and medium family Enterprise after exit of founders in Kenya*: Unpublished Ph.D thesis Jomo Kenyatta university of Agriculture and Technology.

xix. Otengo, M. (2016). *Factors influencing the use of Business Advisory Services of MSEs in Nairobi City County Kenya.* Unpublished PHD thesis Jomo Kenyatta university of Agriculture and Technology.

xx. Ramadan, A. (2009). *Determinants of capital structure and the firm's financial performance.* An application of UK Capital market. Doctoral Dissertation University of Survey.

xxi.   Saunders, M., Lewis, P., & Thornhill, A. (2009). *Research methods for Business student*, 5th Edition, Great Britain, Prentice hall.

xxii.   Sosa-Escudero, W. (2009). *Econometrics Analysis*, Final Remarks, Spring 2009, Econ 507.

xxiii.   Turyahebwa, R., Sunday, A., & Ssekajudo, D., (2013*). Financial management practices of SME in western Uganda*. African journal of business management. Vol. 7(38). pp 3875-3885

Appendix

Research Questionnaire for Enterprises

The purpose of this questionnaire is to examine effect of the financing costs on financial performance of micro and small enterprises in Starehe, Nairobi City County.

Section A: General Information

1.   Fill your details in the table below

State your gender	State your age in years	State your highest level of education	State your marital status	State your sector of business operation	State your relationship with Business
Male	18-28yrs 〔 〕	KCPE/KCE〔 〕	Single 〔 〕	Trade 〔 〕	Owner 〔 〕
Female	19-38yrs 〔 〕	KCSE 〔 〕	Married 〔 〕	Transport, Telecommunications & Storage 〔 〕	Manager〔 〕
	39-48yrs 〔 〕	Diploma〔 〕	Divorced 〔 〕	Agri-businesses, Forestry & Natural Resources 〔 〕	Both owner & Manager〔 〕
	49-58yrs 〔 〕	1st Degree〔 〕	Separated〔 〕	Catering	Other ....〔 〕
	59yrs and above〔 〕	Masters 〔 〕	Widowed 〔 〕	Education, Health & entertainment	
		PhD 〔 〕		Manufacturing	

Table 14

Section: B financing costs

2.   Please indicate the amount of your initial capital, the source, administrative cost; family loan cost; friends loan cost, of the facility (if any) and the rate of interest paid per year in the table below where figures are in KSH.

Source	Amount	Administrative costs	Family loan cost	Friends loan cost	Amount of interest/Return per year
Family Loan	Below 50,000 〔 〕 50001-200000〔 〕 Above 200001〔 〕	N/A	Nil 0-15,000 〔 〕 15001-60000〔 〕 Above-60000 〔 〕 N/A	N/A	N/A
Bank Loan	Below 50,000 〔 〕 50001-200000〔 〕 Above 200000〔 〕	0-15,000 〔 〕 15001-60000〔 〕 Above-60000〔 〕	N/A	N/A	Less 20000 〔 〕 20001-30000 〔 〕 Above 30000 〔 〕
Loan from friends	Below 50,000 〔 〕 50001-200000〔 〕 Above 200000 〔 〕	N/A	N/A	Nil 0-15,000 15001- 〔 〕 60000 〔 〕 Above- 〔 〕 60000 〔 〕 N/A	N/A
Loan from Sacco	Below 50,000 〔 〕 50001-200001〔 〕 Above 200000〔 〕	0-15,000 〔 〕 15001-60000 〔 〕 Above 60000 〔 〕			Less 20000 〔 〕 20001-30000 〔 〕 Above 30000 〔 〕

Table 15

3.   Any other comment you would like to make about financing costs and their effect on business performance...

YEAR	Less 50,000	50,000-100,000	100,001-200,000	200,000-300,000	Above 300,000
2014	〔 〕	〔 〕	〔 〕	〔 〕	〔 〕
2015	〔 〕	〔 〕	〔 〕	〔 〕	〔 〕
2016	〔 〕	〔 〕	〔 〕	〔 〕	〔 〕
2017	〔 〕	〔 〕	〔 〕	〔 〕	〔 〕

Section B; Financial Performance

4. Indicate the level of your MSE business profit(KSH) by filling the table below
5. What is the value of your assets now? (ksh)
   Below 100,000   〔 〕   100,000-200,000   〔 〕200,001-500,000   〔 〕above 500, 000
6. What is your total capital invested now? (ksh)
   Below 50,000   〔 〕   50,001-200,000   〔 〕 200,001-300,000   〔 〕300,001-400,000
   400,001- 500,000 〔 〕   Above 50,000   〔 〕
7. Indicate your total sales by filling the table below(KSH)
8. Any other comment you would like to make about your business performance?

Thank you for filling this questionnaire

Category	Index name	Acceptance range	Comments
Absolute fit	Chi-square	P > 0.05	Sensitive to sample size >200
	RMSEA (root mean square of error)	RMSEA < 0.08	0.05 to 0.1
	GFI (goodness of fit index)	GFI > 0.9	Value of 0.95 is a good fit
Incremental fit	CFI (comparative fit index)	CFI > 0.9	Value of 0.95 is a good fit
	TLI (Tucker-Lewis index)	TLI > 0.9	Value of 0.95 is a good fit
	NFI (normal fit index)	NFI > 0.9	Value of 0.95 is a good fit
Parsimonious Fit	Chisq/df	Chisq/df < 5.0	Value should be less than 5.0

Table 16: Level of Acceptance for Fitness Indices
Adapted from Zainudin, (2014)