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The Factors that Affect Accessibility to Credit Services by Small Scale Sugarcane Farmers in Kenya: A Case of Bungoma County, Kenya

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Abstract

This study examined the factors that affect accessibility to credit services by small scale sugarcane farmers in Bungoma County. The main objective of this study was to assess the role of the institutional lending policies of formal credit institutions in determining the access to and use of credit facilities by small-scale entrepreneurs in rural Kenya. The study was guided by the following specific objectives: (i) to analyze the main features of the lending policies of formal credit institutions that determine the access to and use of credit by small-scale sugar cane farmers in Kenya; too assess the factors that determine the participation of small-scale sugar cane farmers in credit markets and their choice of credit sources in Kenya; to evaluate the factors considered by formal credit institutions in formulating their credit policy to meet the needs of small scale sugarcane farmers in Kenya. The samples comprised of the 10 commercial banks that extend credit to SMEs were considered for this study. The target respondents were the credit managers. The procedures that was used in collecting data is through interviewer administered questionnaires and distribution of self administered questionnaires that is dropping and picking questionnaires from respondents at their most convenient time and personally collected them from respondents once completed. Data collected was analyzed by use of descriptive statistics such as percentages, mean scores and standard deviations. Statistical Package for Social Sciences (SPSS) was used as an aid in the analysis since it reduces lots of data into simpler summary. It concluded that informal credit sources provide easier access to their credit facilities for small and micro enterprises. Another important conclusion for improving access to credit that emerges from this study is that given the wide and established branch network of commercial banks, improving their lending terms and conditions in favor of small-scale enterprises would significantly facilitate the accessibility of small-scale enterprises to credit. Given the relatively abundant financial resources of the formal institutions compared with informal credit sources, there is need for policy measures to increase access of SMEs to formal credit. This can be achieved through the establishment of credit insurance schemes protecting the financial institutions against default risks, which result in credit rationing. The formal financial institutions should also be encouraged to diversify their loan portfolios so as to be able to cater for the different financial needs of SMEs. There is also need to expand the capacity of informal credit sources to enable them to increase their potential to lend to SMEs. Since formal institutions are mainly concerned with default problems and loan administration costs, linking their operations with those of informal lenders can help to ensure that they reach more potential borrowers. This is because informal lenders have their own insurance mechanisms, which guarantee loan repayment, yet they lack adequate financial resources to enable them to expand their coverage. SMEs also must be profitable in order to grow and be able to attract more external finance. It is therefore necessary to provide a policy environment that affords the necessary incentives for enterprise growth.

Keywords: Accessibility to credit services, Small scale sugarcane farmers, Small and Micro Enterprises, Credit Institutions, Rotating savings and credit associations

ABBREVIATIONS

CBK	Central Bank of Kenya
CBS	Central Bureau of Statistics,
ICDC	Industrial and Commercial Development Corporation
MFIs	Micro Finance Institutions
NBFIs	Non-bank financial institutions
NGOs	Non-Governmental Organizations
OECD	Organization for Economic Co-operation and Development
ROSCAs	Rotating Savings and Credit Associations
SACCOs	Savings and Credit Co-operatives
SMEs	Small and Micro Enterprises
SPSS	Statistical Package for Social Sciences

1.0 INTRODUCTION

1.1 Background of the Study

The provision of credit has increasingly been regarded as an important tool for raising the incomes of rural populations, mainly by mobilizing resources to more productive uses. As development takes place, one question that arises is the extent to which credit can be offered to the rural poor to facilitate their taking advantage of the developing entrepreneurial activities. The generation of self-employment in non-farm activities requires investment in working capital. However, at low levels of income, the accumulation of such capital may be difficult. Under such circumstances, loans, by increasing family income, can help the poor to accumulate their own capital and invest in employment-generating activities (Republic of Kenya, 2005).

Small scale farming forms an important sector in most developing economy. In recent years financial support for this sector has become a major component of the strategy for poverty alleviation. Several microfinance schemes provide loans to enable potential entrepreneurs start small scale enterprises. Unfortunately these schemes only provide subsistence living with proprietor with no possibility of providing jobs for others in the community. In order to move the activities of microfinance from subsistence living to small scale enterprises it is necessary to inject technology into the various activities (Nyoro, 1986)

Access to credit by small scale farmers is an important factor in improving agricultural productivity and strengthening the economy in rural economy in developing countries. However the ability of farm access to credit is implicated by factors that influence the accessibility of these services. Such factor includes availability of nearby financial institution, collateral requirement, financial costs, rigid lending policies and education level of farmers. In the past commercial banks would not consider extending credit to individual farmers unless they went through cooperative societies that kept financial records.

Bungoma County is a district in the Western Province of Kenya. Its capital town is Bungoma , and currently has a population of 1.4 million people. The economy of Bungoma County is mainly agricultural, centering on the sugar cane and maize farming. The area experiences high rainfall throughout the year which favours agricultural production, and has several large rivers which are used for small-scale irrigation. Barclays Bank, Kenya Commercial Bank, National Bank of Kenya, Equity Bank, Family Bank, Post Bank are among the formal financial institutions running branches in Bungoma that offer financial services. Startup capital is one of the major problems facing small scale sugarcane farmers in Bungoma. Since income levels are low and most people have not been build up savings on their own starting a new business becomes a difficult task. This is where access to funding from financial institutions becomes important. A key constraint in accessing loans from banks comes from the principles for designing financial services by banks, the financial institutions approach to dealing with the problems of poor information, high transaction costs, repayment risk management and sources of funds. In many cases small scale sugarcane farmers are not able to assess loans because of conditions attached to the banking lending policies.

This study aims at analyzing the credit policies in the rural financial markets with the view of establishing their role in determining the access of small-scale enterprises to financial services from formal sources in rural Kenya with a focus on the commercial banks located in Bungoma County.

1.1.1 Small and Micro Enterprises

The common definition adopted by the Organization for Economic Co-operation and Development (OECD) countries is based on employment figures; an SME has less than 500 employees (OECD, 2000). The South African SME Act, on the other hand, defines SMEs as having up to 100-200 employees or a turnover of five million Rand (US$833,000), while micro enterprises have up to five employees. In Egypt, the Ministry of Trade has definitions based on three criteria: (i) the number of workers; (ii) fixed assets; and (iii) annual turnover (Rizk, 2004). The common definition in OECD (Organization for Economic Co-operation and Development) countries is based on employment figures; correspondingly an SME has less than 500 employees (OECD, 1997). In Kenya, Micro-enterprises are those with 10 or fewer workers, small enterprises have from 11 to 50 workers, and medium enterprises have from 51 to 100 workers. (Southwood, 2004)

1.1.2 Small and Micro Enterprises in Kenya

In Kenya, SMEs are defined as businesses in both formal and informal sectors, classified into farm and non-farm categories employing 1-50 workers (Republic of Kenya, 2005). The sector is considered as one of the major contributors to the economy by providing income and employment to a significant proportion of the population, the Government has recognized the potential of the SME sector in employment creation and poverty reduction in its numerous policy documents. According to the Economic survey 2004, employment within the SME sector increased from 4.2 million persons in 2000 to 5.5 million persons in 2003 accounting to 75.3 percent of the total persons engaged in 2003. The sector contributes up to 18.4 per cent of the country's Gross Domestic Production (CBS, 1999). The SME sector should therefore not only be seen as a provider of goods and services, but also as a driver of competition and innovation, enhancing the enterprise culture which is necessary for private sector development and industrialization (Republic of Kenya, 2005)

1.2 Statement of the Problem

Small scale sugarcane farmers may need access to credit services in order to meet their cash demands e.g. children education, medical costs, labour cost. The farmers may also need to participate in other economic activities other than sugarcane growing. The reduction in farming units due land subdivision, increased number of farmers, thus reducing per capita small scale farming incomes, rigid banking policies (i.e. on lending or minimum deposits) and lack of enough information on the farmers earning and spending habits (know your client type of information), credit service providers find it risky and thus costly to take credit services closer to the small scale sugarcane farmers.

Improving the availability of credit facilities to this sector is one of the incentives that have been proposed for stimulating its growth and the realization of its potential contribution to the economy. Despite this emphasis, the effects of existing institutional problems, especially the lending terms and conditions on access to credit facilities, have not been addressed. In addition, there is no empirical study indicating the potential role of improved lending policies by both formal and informal credit institutions in alleviating problems of access to credit. Knowledge in this area, especially a quantitative analysis of the effects of lending policies on the choice of credit sources by entrepreneurs, is lacking for the rural financial markets of Kenya.

Although informal credit institutions have proved relatively successful in meeting the credit needs of small enterprises in some countries, their limited resources restrict the extent to which they can effectively and sustainably satisfy the credit needs of these entrepreneurs. This is because as micro enterprises expand in size, the characteristics of loans they require become increasingly difficult for informal credit sources to satisfy, yet they still remain too small for the formal lenders.

Studies related to small and micro enterprises in Kenya include: Rukwaro (2001) undertook a study on credit rationing by micro finance institutions and its influence on the operations of small and micro enterprises; Wanyungu (2001) focused on the financial management practices of micro and small enterprises in Kibera, Kenya; Mwindi (2002) focused on the relationship between interest rates charged by MFIs and performance of micro and small enterprises in Nairobi; Kilonzo (2003) focused on the relationship between financial structure and performance of micro and small enterprises in Nairobi; and Mwaura (2003) focused on the environment as a moderator of the relationship between business strategy and performance, a case of SMEs in Kenya. None of the above studies focused on the factors that affect accessibility to credit services by small scale sugar cane farmers in Kenya. A relevant issue for investigation is therefore that of the factors behind the existence of formal credit sources in the Kenyan market.

1.3 Objectives of the Study

1.3.1 General objective

The main objective of this study was to assess the role of the institutional lending policies of formal credit institutions in determining the access to and use of credit facilities by small-scale entrepreneurs in rural Kenya.

1.3.2 Specific objectives

The study was guided by the following specific objectives:

(i) To identify the main features of the lending policies of formal credit institutions that determine the access to and use of credit by small-scale sugar cane farmers in Kenya.

(ii) To assess the factors that determine the participation of small-scale sugar cane farmers in credit markets and their choice of credit sources in Kenya.

(iii) To evaluate the factors considered by formal credit institutions in formulating their credit policy to meet the needs of small scale sugarcane farmers in Kenya.

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the literature related to the purpose of the study the chapter is organized according to the specific objectives in order to ensure relevance to the research problem. The review is undertaken in order to eliminate duplication of what has been done and provide a clear understanding of existing knowledge base in the problem area.

2.2 Theoretical and conceptual issues in financial markets

An increasing body of analytical work has attempted to explain the functioning of credit markets using new theoretical developments. They have explored basing on incomplete markets and lack of clear information for the functioning of credit markets in developing countries. Most of this body of literature has followed from the work of Stiglitz and Weiss (2000). The work by Stiglitz and Weiss (2000) marks the beginning of attempts at explanations of credit rationing in credit markets. In this explanation, interest rates charged by a credit institution are seen as having a role of selecting potential borrowers and affecting the actions of borrowers. Interest rates thus affect the nature of the transaction and do not necessarily clear the market. Both effects are seen as a result of the lack of clear information in credit markets.

Selection of borrowers occurs because lenders would like to identify the borrowers most likely to repay their loans since the banks' expected returns depend on the probability of repayment. In an attempt to identify borrowers with high probability of repayment, banks are likely to use the interest rates that an individual is willing to pay as a screening device. However, borrowers willing to pay high interest rates may on average be worse risks; thus as the interest rate increases, the riskiness of those who borrow also increases, reducing the bank's profitability. The incentive effect occurs because as the interest rate and other terms of the contract change, the behavior of borrowers is likely to change since it affects the returns on their projects (Hossain, 2004).

Besley (2005) argues that since credit markets are characterized by inadequate information and high costs associated with enforcement of lending contract, there will not be an accurate measure against which to define market failure. These problems lead to credit rationing in credit markets. Lenders will fix the interest rates at a lower rate and ration access to credit. Inadequate information is therefore important in explaining the existence of credit rationing in rural credit markets. An increase in interest rates negatively affects the borrowers by reducing their incentive to take actions necessary to loan repayment. This will lead to the possibility of credit rationing.

2.3 Access to financial services

Access to financial services by small scale enterprises is normally seen as one of the constraints limiting their benefits from credit facilities. However, in most cases the access problem, especially among formal financial institutions is one created by the institutions mainly through their lending policies e.g. minimum loan amounts, complicated application procedures and restrictions on credit for specific purposes (Schmidt and Kropp, 2003). Schmidt and Kropp (2003) further argue that the type of financial institution and its policy will often determine the access problem. Where credit duration, terms of payment, required security and the provision of other services do not fit the needs of the customers, potential borrowers will not apply for credit even where it exists and when they do, they will be denied access.

The Grameen Bank experience shows that most of the conditions imposed by formal credit institutions like collateral requirements should not actually stand in the way of small scale borrowers and the poor in accessing credit. The poor can use the loans and repay if effective procedures for obtaining, supervision and repayment have been established. The bank also supports the view that high interest rate credit can help to keep away the influential non-target group from a targeted credit programme (Hossain, 2004). This further demonstrates the need to develop appropriate lending policies for institutions in the delivery of loans to small-scale borrowers.

2.4 Characteristics of credit markets in Africa

Credit markets in Africa have mainly been characterized by their inability to satisfy the existing demand for credit in rural areas. However, whereas for the informal institutions the main reason for this inability is the small size of its resources , for the formal institutions it is the difficulties in loan administration like screening and monitoring, high transaction costs, and the risk of default. Credit markets are characterized by inadequate information, agency problems and poor contract enforcement mechanisms (Nissanke and Aryeetey, 2004). The informal and formal sectors offer similar products that are not entirely the same, implying that both sectors cater to the needs of easily identifiable groups of individuals and businesses, but at the same time serve sections of the total demand for financial services. Besley (2005) has classified major features of rural credit markets that can be used to explain the existence of formal and informal credit markets in Africa. Among these are the existence of collateral security and covariant risk. Collateral security is often limited to many borrowers in rural areas. But even where this is not the case, the ability to foreclose loan repayment is often limited, making enforcement difficult. In most rural economies, borrowers are faced with risks arising from uncertainties about their incomes therefore by diversifying their loan portfolios, lenders can avoid such risks.

Another important factor of both formal and informal markets relates to penalties. In the absence of formal contract enforcement mechanisms, both formal and informal institutions rely on lending practices that emphasize loan screening rather than monitoring. Differences emerge in the methods used by formal and informal institutions. Whereas formal lenders rely more on project screening, informal lenders rely more on the character and history of the borrower, particularly on personal knowledge of the borrower. Informal institutions rarely rely on loan monitoring due to the lenders' knowledge of borrowers, while in the formal market it is mainly due to lack of facilities. Transaction costs are generally lower in informal markets than in formal ones. The literature review shows that financial markets in African countries are characterized by lack of adequate and costly information, risks, and market segmentation, resulting in credit rationing. This is one of the underlying factors in both formal and informal credit markets serving the needs of the different customers.

2.4.1 Loan screening, monitoring and contract enforcement

Unlike formal finance, informal lenders often attach more importance to loan screening than to monitoring the use of credit. Screening practices often include group observation of individual habits, personal knowledge by individual moneylenders and recommendations by others, and creditworthiness. In group lending programmes, members are made jointly liable for the loans given. The joint liability plus the threat of losing access to future loans motivates members to perform functions of screening loan applicants, monitoring borrowers and enforcing repayment. (Zeller, 2004a). In group lending, the credit institutions reduce the transaction costs by replacing multiple small loans to individuals by a large loan to a group. This enables them to meet the needs of the poor loan applicants who would not receive any loans under individual loan contracts due to high transaction costs (Huppi and Feder, 2000)..

2.5 Structure and performance of the financial sector in Kenya

2.5.1 Overview of the Kenyan financial sector

Kenya's financial sector grew steadily in the 1990s with the assets of the banking system more than doubled between 1990 and 1995, while those of the non-bank financial institutions (NBFIs) increased by 16% over the same period. The composition of the institutions as at 1998 consisted of 55 commercial banks, up from 48 in 1997; 16 non-bank financial institutions from 24 in 1997; 4 building societies; and 2 mortgage finance companies (Central Bank of Kenya, 1998). The rapid growth of NBFIs was due to the lower entry requirements for NBFIs, which also faced no interest rate restrictions and were therefore able to attract more deposits by charging higher interest rates.

The number of commercial banks declined sharply after that and is currently at 43 registered commercial banks in Kenya(CBK, 2008).The Kenyan banking sector is dominated by a few large firms, which focus mainly on short-term lending. Of the 43 commercial banks operating in the country, the largest four control 81% of the deposits. The short-term nature of their lending and their policies of concentrating on small scale entrepreneurs has implied indifference to small savers and borrowers. This has meant that they mostly target small scale entrepreneurs. Commercial banks face many challenges in today's dynamic marketplace. In a global economy that has become increasingly competitive, there is need for efficient development of products that can quickly satisfy a more demanding customer base and build long-term customer trust (CBK 2008). Informal credit sources in Kenya comprise traders, relatives and friends, ROSCAs, welfare associations, and moneylenders. An important issue addressed by this study is the underlying factors behind the existence of the formal and informal credit institutions, which account for the differences in their ability to satisfy the credit demand by small-scale enterprises.

2.5.2 Rural financial market in Kenya

A number of institutions provide credit to the small and micro enterprise sector in Kenya. These include commercial banks, non-bank financial institutions, non-government organizations, multilateral organizations, business associations, and rotating savings and credit associations. In addition, financial transactions also take place between traders, friends, relatives and landlords, as well as commercial moneylenders. Few small and micro enterprise sectors are able to provide collateral that guarantee requirements of commercial banks, with the result that SMEs lacking such requirements have not been able to obtain credit from banks.

The advantage of commercial banks is that they have a wide branch network that can reach most micro enterprises in rural areas. They also operate accounts, which make it possible to monitor their clients closely. Most of them are located in urban areas with few branches located in rural centres, making it difficult to provide adequate services to those micro enterprises located in rural areas. Given that up to 78% of the SMEs are located in rural areas, this is a major limitation on the extent to which commercial banks can serve them. Other limitations of commercial bank lending to the SME sector in Kenya are the lack of appropriate savings instruments to mobilize savings to the SMEs and the restrictions on withdrawals, which discourages savers who would like frequent access to their savings. Their location away from many enterprises also implies high transaction costs, which discourage most enterprises from using their savings and other services.

In the recent past, a number of non-government organizations (NGOs) have been involved in financing of microenterprises. Most NGOs have not had positive performance, however their inexperience in financial intermediation and limited financial resources have constrained their potential. There is little coordination among the NGOs, resulting in duplication of resources and activities. Most of them have high credit costs, are donor based and sponsored, lack adequate funding, and are limited in their geographical coverage. They also discriminate against small-scale enterprises who get rationed out by lenders since cheap credit creates excess demand for loanable funds, forcing lenders to lend to large enterprises that have collateral and are perceived to be less risky. Rotating savings and credit associations (ROSCAs) are also an important source of credit in the country. These are found in both rural and urban areas as either registered welfare groups or unregistered groups. They mainly provide credit to those who would likely be ineligible to borrow from other sources. ROSCAs have developed mostly in response to the lack of access to credit by SMEs, forcing them to rely on their own savings and informal credit sources for their.

2.5.4 Financial institutions serving small and micro enterprises in Bungoma County, western Kenya

There are a number of credit institutions that support small and micro enterprise activities in Bungoma County. These include commercial banks, development finance institutions, NGOs, and rural credit organizations like SACCOs and ROSCAs. There are also a number of financial transactions taking place outside these institutions, like those between relatives and friends, traders, and welfare groups (KREP, 2007). An inventory survey of financial institutions in western Kenya by KREP documents the main lending institutions in the region. Barclays Bank offers loans for women entrepreneurs both as individuals and in groups. Under the Barclays Bank of Kenya Credit Scheme, the bank offers credit to small and large enterprises engaged in off-farm activities. Commercial rates of interest are applicable with no lower or upper limits.

The scheme aims at stimulating small businesses by removing some of the constraints on bank lending to the sector. In western Kenya, the scheme operates in Bungoma and Kisumu, with the two areas having a total of 14.8% of the clients nationally. Care International focuses on pre-existing organized rural groups. Its credit programme targets women owners of micro enterprises. Clients are required to raise equity cash of 25% of the total loan required. The loan security is the group members who guarantee each other and are collectively guaranteed by the group. Credit is advanced to the group, which lends to its members individually. Other institutions include Industrial and Commercial Development Corporation (ICDC), which operates credit schemes including one that caters for retail and wholesale traders for working capital, SACCOs also provide both savings and credit facilities to their members. The amount of credit provided depends on the amount of the individual members' savings, but the use of money is not restricted (KREP, 2007).

2.5.4 Loan security

Loan security is one of the important features that determine credit accessibility by SMEs. Most lending to small-scale enterprises is based on security, without any regard for potential cash flow. However, organizations lending to microenterprises have devised alternative forms of collateral. These include; group credit guarantees, where organizations lend to individuals using groups as guarantors, and personal guarantors, where individuals are given loans based on a guarantor's pledge (Dondo, 2000). Loan guarantee schemes are increasingly being implemented as a means of encouraging financial institutions to increase their lending to the risky sectors and those without the traditional formal security.

2.6 Conceptual framework

Many researches on formal and informal credit sources in Kenya have been done to estimate the factors that determine an individual's borrowing decisions, in terms of their participation in formal or informal credit markets. The market segments are treated separately in order to identify similarities and differences between the sectors in credit applications and rationing. The results show that among the informal lenders, age, schooling, wage income, sick days and household headship are significant determinants of applications for credit. On the other hand, gender and social events are not significant (Waweru 2008).

Zeller (2004b) divides the factors into individual characteristics, labor assets, household events that affect credit demand, and reasons for participation. This approach assumes that an individual's decision is only affected by internal factors. However, external factors also play an important role in influencing participation in credit markets. A number of difficulties have been identified in estimating credit demand, especially in markets where financial institutions are highly concentrated with lack of clear information. In most research where there is the possibility of loan default due to unclear procedures it is assumed that borrowers are restricted to certain limit of loan. The credit demand can only be identified from the borrower's participation decision, for instance, the decision to borrow or not and from which sector to borrow (Mullei ,2003).

Apart from the difficulties in identifying demand for credit ,estimates of loan demand are often biased because they use models that do not adequately correct for selectivity bias or they use data that do not account for the existence of multiple loans Nagarajan *et al*. (2000) . Bigsten *et al.* (2003) estimate credit market participation and constraints faced by firms by investigating the demand for funds by firms and assessing the decision rules used by financial institutions to grant loans. Since applying for funds has transaction costs, firms can build internal funds from retained profits. They argue that in managing credit risk, the factors that determine whether firms have a demand for credit are expected return on investment, the opportunity cost of using their own funds and the cost of outside funds. Given lack of flexibility in lending policies, firms may prefer external funds, but would not access due to their inability to meet collateral requirements and high costs associated with loan application (Kithinji and Waweru, 2007).

3.0 METHODS

3.1 Introduction

This chapter covers a description of the research design, target population, sample and sampling procedure, data collection and data analysis.

3.2 Research Design

Research design provides the glue that holds the research project together. A design is used to structure the research, to show how all of the major parts of the project ; the samples or groups, measures, treatments or programs, and methods of assignment work together to try to address the central research questions (Brown ,2003). For purposes of this study, a case study research design was used. It is an empirical inquiry that investigates a contemporary phenomenon within its real life context; when boundaries between phenomenon and context are not clearly evident and in which multiple sources evident are used. A case study generally aims to provide insight into a particular situation and often stresses the experiences and interpretations of those involved. Case studies involve collecting empirical data, generally from one or a small number of cases (Yin, 2004).

3.3 Target Population

The population of study was the commercial banks located in Bungoma County.

3.4 Sample and sampling procedure

It would have been desirable to undertake a census of all the commercial banks in Kenya, but owing to their big numbers, currently 43 registered commercial banks with their branches spread all over the country which would have serious cost implications, 10 commercial banks that extend credit to SMEs were considered for this study. The target respondents were the credit managers.

3.5 Data Collection

The procedures that was used in collecting data is through interviewer administered questionnaires and distribution of self administered questionnaires that is dropping and picking questionnaires from respondents at their most convenient time and personally collected them from respondents once completed. This provided an opportunity to clarify certain issues arising from the various respondents.

3.6 Data Analysis

Data collected was analyzed by use of descriptive statistics such as percentages, mean scores and standard deviations. Statistical Package for Social Sciences (SPSS) was used as an aid in the analysis since it reduces lots of data into simpler summary.

4.0 RESULTS AND DISCUSSIONS

4.1 Introduction

The study utilized a combination of both quantitative and qualitative techniques in the collection of data. The study examined the factors that affect accessibility to credit services by small scale sugarcane farmers in Kenya. Focus of the study was the commercial banks located in Bungoma County, Western Province, whose number stood at 10. A census was undertaken and each of the banks was represented in the study by the person in charge of credit. All the questionnaires that were distributed were returned completed, (100%) response rate. The data was analyzed by employing descriptive statistics such as percentages, frequencies and tables. Statistical Package for Social Sciences (SPSS) was used to aid in analysis. The researcher preferred SPSS because of its ability to cover a wide range of the most common statistical and graphical data analysis and is very systematic. Mean scores were used to indicate measures of central tendency while standard deviations were used to indicate measures of dispersion. Computation of frequencies in tables, charts and bar graphs was used in data presentation. The information is presented and discussed as per the objectives and research questions of the study.

4.2 Background information

This section presents a summary of responses with respect to the background information of respondents.

Time period organization has been in existence: Respondents were asked to specify their organization's period of existence; responses are summarized and presented in figure 4.1 below.

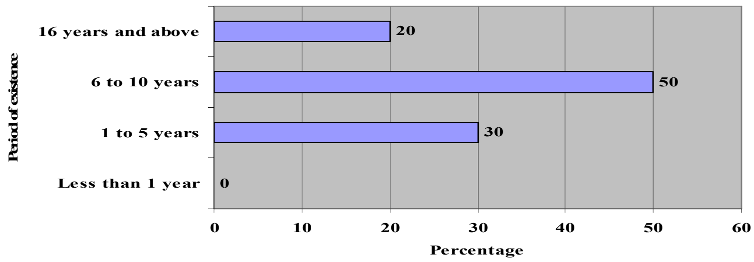

Figure 4.1: period of existence

The findings in figure 4.1 above show that half of the respondent organizations (50%) has been in existence for a period of between 6 to 10 years, (30%) of the organizations has been in existence for a period of between 1 to 5 years, (20%) of the organizations has been in existence for more than 16 years and none of the organizations has been in operation for less than an year.

4.2.2 Period of working in the current organization

Respondents were asked to give the period of working in their current work station in the organization; responses are summarized and presented in figure 4.2 below.

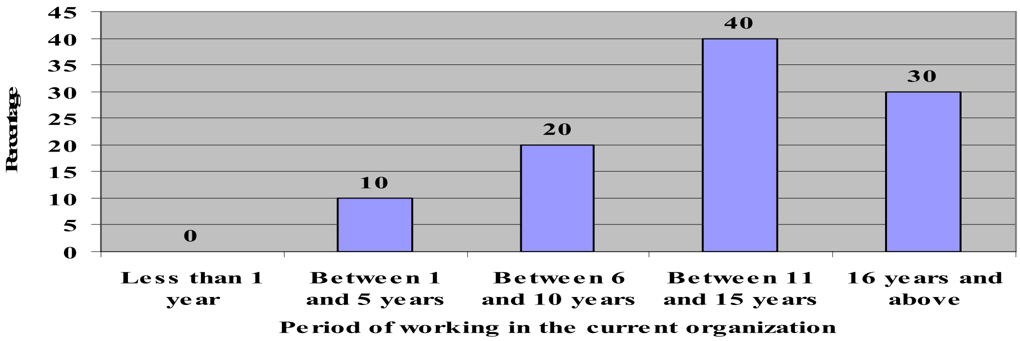

Figure 4.2 Period of working in the current organization

The findings in figure 4.2 above shows that majority of the respondents (40%) have been in their current work station for a period of between 11 and 15 years, (30%) of the respondents have been in their current work station for a period of more than 16 years, (20%) of the respondents have been in their current work station for a period of between 6 and 10 years, (10%) of the respondents have been in their current work station for a period of between 1 and 5 years and none of the respondents have been in their current work station for less than a year.

4.3 Factors that affect accessibility to credit services by small scale sugar cane farmers in Bungoma County

4.3.1 Features of the lending policies of formal credit institutions

In order to assess the main features of the lending policies of formal credit institutions, respondents were asked to indicate the extent to which each of the listed features determine lending policies by their organizations. Responses are summarized and presented in table 4.1 below. ***Where:*** Not at all = **(1)**; Very little = **(2)**; Somehow = **(3)**; Much = **(4)**; Very much = **(5)**

Table 4.1 Features of the lending policies of formal credit institutions

Features of the lending policies of formal credit institutions		1	2	3	4	5	Mean	Std. dev.
Loan amounts	Percentage	0	10	20	40	30	3.90	.994
	Frequency	0	1	2	4	3		
Loan applications	Percentage	0	0	30	30	40	4.10	.876
	Frequency	0	0	3	3	4		
Restrictions on credit purposes	Percentage	20	20	30	20	10	2.80	1.317
	Frequency	2	2	3	2	1		
Collateral	Percentage	0	20	30	40	10	3.40	.996
	Frequency	0	2	3	4	1		
Loan administration difficulties	Percentage	20	10	20	40	10	3.10	1.370
	Frequency	2	1	2	4	1		
Transaction costs	Percentage	0	0	30	40	30	4	.816
	Frequency	0	0	3	4	3		
Default risks	Percentage	20	30	30	20	0	2.50	1.080
	Frequency	2	3	3	2	0		
Contract enforcement	Percentage	0	0	30	40	30	4	.816
	Frequency	0	0	3	4	3		
Customer information	Percentage	0	30	30	40	0	3.10	.876
	Frequency	0	3	3	4	0		
Procedures	Percentage	0	20	30	50	0	3.30	.823
	Frequency	0	2	3	5	0		
Loan processing	Percentage	0	0	30	40	30	4	.816
	Frequency	0	0	3	4	3		
Loans disbursement procedures	Percentage	0	20	30	20	30	3.60	1.174
	Frequency	0	2	3	2	3		
Interest rates	Percentage	0	0	30	30	40	4.10	.876
	Frequency	0	0	3	3	4		
Credit duration	Percentage	0	10	30	20	40	3.90	1.101
	Frequency	0	1	3	2	4		
Terms of payment	Percentage	40	30	20	10	0	2	1.054
	Frequency	4	3	2	1	0		
Supplementary services	Percentage	20	40	30	10	0	2.30	.949
	Frequency	2	4	3	1	0		
Travel costs	Percentage	0	30	30	20	20	3.30	1.160
	Frequency	0	3	3	2	2		
Penalties	Percentage	0	20	40	20	20	3.40	1.075
	Frequency	0	2	4	2	2		
Size of transactions	Percentage	0	30	30	20	20	3.30	1.160
	Frequency	0	3	3	2	2		

4.3.2 Factors that determine the participation of small-scale sugar cane farmers in credit markets and their choice of credit sources in Kenya

In order to assess the factors that determine the participation of small-scale farmers in credit market, respondents were asked to indicate the extent to which they agree/disagree that each of the listed factors determine the participation of small-scale farmers in credit markets. Responses are summarized and presented in table 4.2 below. ***Where:*** Strongly disagree = **(1)**; Disagree = **(2)**; Somehow = **(3)**; Agree = **(4)**; Strongly agree = **(5)**

Table 4.2: Factors that determine the participation of small-scale farmers in credit markets

Factors that determine the participation of small-scale farmers in credit markets		1	2	3	4	5	Mean	Std. dev.
Enterprise factors								
Main occupation	Percentage	0	20	10	40	30	3.80	1.135
	Frequency	0	2	1	4	3		
Household size	Percentage	0	0	40	50	10	3.70	0.675
	Frequency	0	0	4	5	1		
Number of owners	Percentage	0	20	40	40	0	3.20	0.789
	Frequency	0	2	4	4	0		
Revenue from the enterprise	Percentage	0	10	30	40	20	3.70	0.949
	Frequency	0	1	3	4	2		
Income levels of applicants	Percentage	0	0	20	50	30	4.10	0.738
	Frequency	0	0	2	5	3		
Distance to credit source	Percentage	0	20	30	40	10	3.40	0.966
	Frequency	0	2	3	4	1		
Age of enterprise	Percentage	20	20	20	10	30	3.10	1.595
	Frequency	2	2	2	1	3		
Past credit participation and assets owned	Percentage	0	20	30	40	10	3.40	0.966
	Frequency	0	2	3	4	1		
Loan terms and conditions imposed by lenders								
Application fee	Percentage	0	0	0	50	50	4.50	0.527
	Frequency	0	0	0	5	5		
Collateral value	Percentage	0	20	30	20	30	3.60	1.174
	Frequency	0	2	3	2	3		
Application period	Percentage	0	10	40	20	30	3.70	1.059
	Frequency	0	1	4	2	3		
Repayment period	Percentage	0	0	30	40	30	4	.816
	Frequency	0	0	3	4	3		
Other services provided with credit	Percentage	20	10	30	40	0	2.90	1.197
	Frequency	2	1	3	4	0		
Whether credit is given for specific use	Percentage	0	20	30	40	10	3.40	.966
	Frequency	0	2	3	4	1		

4.3.3 Factors considered when formulating organizations' credit policy

In order to evaluate the factors considered when formulating organizations' credit policy, respondents were asked to tick appropriately to the factors listed. Reponses are summarized and presented in table 4.3 below. ***Where:*** Not at all = **(1);** A little important = **(2);** Important = **(3);** Very Important = **(4);** Critically Important = **(5)**

Table 4.3 Factors considered when formulating organizations' credit policy

Factors considered when formulating organizations' credit policy		1	2	3	4	5	Mean	Std. dev.
Competitiveness in banking industry	Percentage	0	0	20	40	40	4.20	0.789
	Frequency	0	0	2	4	4		
Geographical location	Percentage	0	0	40	20	40	4	0.943
	Frequency	0	0	4	2	4		
Desired profit margins	Percentage	0	20	40	20	20	3.40	1.075
	Frequency	0	2	4	2	2		
Desired market share	Percentage	20	20	30	10	20	2.90	1.449
	Frequency	2	2	3	1	2		
Organizations cash requirement	Percentage	0	0	30	40	30	4	0.816
	Frequency	0	0	3	4	3		

CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents conclusions drawn from the research findings and the recommendations for practice and for further studies.

5.2 Summary

The study had the objective of assessing the role of the institutional lending policies of formal and informal credit institutions in determining the access to and use of credit facilities by small-scale sugar cane farmers in Bungoma County. A field survey was conducted in which primary data were collected using a structured questionnaire. A total of 10 Credit managers from the various commercial banks in Bungoma County that extend credit to Small-scale sugar cane farmers were interviewed. The study used mainly descriptive statistics in the analysis.

The results showed that most enterprises had not used credit before. Out of those who had, the majority had used informal sources. The major reasons for not seeking credit were lack of information about credit and lack of required security. The use of specific credit sources, either formal or informal, was justified as the only source available. This may indicate the existence of only a limited range of options to choose from. In both formal and informal markets, personal savings was the dominant source of finance, especially for initial capital, which may point to the inability of the financial markets to meet the existing credit demand and reinforces the argument that small-scale rural based enterprises do not have access to the financial resources of the formal financial sector. When credit access is seen in terms of the rationing behavior of lenders, we find that majority of the small-scale farmers are credit constrained, and a very small percentage ever apply for credit. Evidence of credit rationing was observed in both markets, as indicated by the significant difference between amount applied for and amount received. Within the informal market, however, family sources display no rationing compared with the other market categories.

Loan rationing in the informal credit market is attributed to the limited resource base, while for the formal sector it is due to the lending terms and conditions. A comparison of household and enterprise characteristics between those who had used credit and those who had not, as well as between those who used formal sources and those who used informal sources, showed that the differences were not significant in both cases. However, the loan terms and conditions all differed significantly between formal and informal credit sources. It is argued that the limited credit use is due to an inadequate credit market, which means that enterprise characteristics may not be important in determining the use of credit. Limited access to credit is therefore seen as a result of supply-side constraints, and not the demand side. The fact that those who did not seek credit because they had relatively higher wealth values may not necessarily mean that they did not need credit. Rather, it may mean that the type of loans they require do not exist, implying that the credit market does not serve the needs of enterprises seeking to expand their business. The result is, therefore, a credit gap capturing those enterprises too big for the informal market, but not served by the formal market.

Studies in other parts of Africa show that different lenders are able to offer different packages in the credit market. Data from this study show that each single lender had a specific credit package offered to borrowers meeting specific conditions. This was particularly true for the group based credit programmes supported by NGOs. We can therefore argue that in the Kenyan credit market, the diversity in informal credit with respect to loan characteristics represents only the different lender types offering different types of loans. The result is that potential borrowers fail to seek credit from informal sources because they do not provide the required credit package.

5.3 Conclusions

A number of conclusions can be drawn from the results of this study. One major conclusion is that the large number of potential borrowers who did not seek credit does not mean that they did not need credit. This result suggests that the lack of supply creates a lack of demand, displayed in the low revealed demand. This has resulted in credit rationing by both the formal and informal credit markets observed from the results and the creation of a credit gap in the market. Hence, although the potential borrowers need credit, the lending terms and conditions prevent them from seeking credit. In the formal sector, these terms focus on concerns with default risk and high transaction costs. In the informal sector, the study suggests that the failure to seek loans is due to the failure by the different lenders to offer the credit package required by specific borrower categories.

It is also concluded that informal credit sources provide easier access to their credit facilities for small and micro enterprises. The main reasons explaining this scenario are the lending terms and conditions reflected in collateral, application procedure and repayment period. However, given that different segments serve specific credit markets, their ability to meet the credit needs of certain enterprises, especially those requiring large amounts of credit as they grow, is limited.

An important conclusion for improving access to credit that emerges from this study is that given the wide and established branch network of commercial banks, improving their lending terms and conditions in favor of small-scale enterprises would significantly facilitate the accessibility of small-scale enterprises to credit. This is because although informal finance provides easier access to credit, the results of the study show that informal credit is confined to specific activities and at lower levels of income, thus limiting its use. This tends to confirm the argument that the nature of credit markets in Africa is such that the lending units are unable to meet the needs of borrowers interested in certain types of credit. The result is that a credit gap is created that captures those borrowers who cannot get what they want from the informal market, yet they cannot gain access to the formal sources because of restrictive lending practices.

5.4 Limitations of the Study

Limitations include the study's restricted focus on SME businesses within one geographical area. The study focused on commercial banks that extend credit to SMEs in Bungoma County only, and considering the diversity of the country, the findings may not be representative of the whole population of SMEs in Kenya. However, the sampling technique used ensured that each respondent had a non-zero chance of being selected to participate in the study. Though the researcher was determined to undertake the study to completion within the given time frame, various constraints were encountered as earlier envisaged. The time allocated for data collection may not have been sufficient to enable the respondents complete the questionnaires as accurately as possible, considering that they were at the same time carrying out their daily duties and priority is of essence. The researcher preferred to administer the data collection tools to only the sampled respondents, however, this was practically not possible as some of them delegated this request since they were either too busy or were away on official duties.

5.5 Recommendations

This section presents the recommendations for policy and practice and suggests areas of further research.

5.5.1 Recommendations for Policy and Practice

Some policy implications can be drawn from the results of this study. Given the relatively abundant financial resources of the formal institutions compared with informal credit sources, there is need for policy measures to increase access of SMEs to formal credit. This can be achieved through the establishment of credit insurance schemes protecting the financial institutions against default risks, which result in credit rationing.

The formal financial institutions should also be encouraged to diversify their loan portfolios so as to be able to cater for the different financial needs of SMEs. There is also need to expand the capacity of informal credit sources to enable them to increase their potential to lend to SMEs. Since formal institutions are mainly concerned with default problems and loan administration costs, linking their operations with those of informal lenders can help to ensure that they reach more potential borrowers. This is because informal lenders have their own insurance mechanisms, which guarantee loan repayment, yet they lack adequate financial resources to enable them to expand their coverage. SMEs also must be profitable in order to grow and be able to attract more external finance. It is therefore necessary to provide a policy environment that affords the necessary incentives for enterprise growth.

5.5.2 Recommended areas of further study

The findings of this study, it is hoped, will contribute to the existing body of knowledge and form basis for future researchers. The following areas of further researcher are thus suggested: (i) Whereas the current study focused on responses from the management of the commercial banks that extend credit to small-scale sugar cane farmers in Bungoma County, future studies should focus on the small-scale farmers themselves, with a view to establishing any variances; and (ii) the present study did not allow for the exploration of the informal lenders' perspectives of, considered to be crucial by the SMEs in Kenya who cannot access credit from formal financial institutions. Given the importance of the informal credit sector, an exploration of their experiences should be undertaken through further research studies, using the same conceptual framework, so that a more holistic understanding of the issues pertaining to this study can be established and a fully coordinated approach can be taken for policy development, implementation and practice.

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APPENDIX II: QUESTIONNIARE

This questionnaire has been designed to collect information from managers or owners of selected commercial banks that extend credit to SMEs in Bungoma County and is meant for academic purposes only. The questionnaire is divided into two sections. Please complete each section as instructed. Do not write your name or any other form of identification on the questionnaire. All the information in this questionnaire will be treated in confidence.

SECTION I: BACKGROUND INFORMATION

1. Please indicate the period of operation of the organization in Bungoma County (Tick as appropriate)

(a) Less than 1 year [ ]

(b) 1 to 5 years [ ]

(c) 6 to 10 years [ ]

(e) 16 years and above [ ]

2. Please list the products/services you offer to the clients

………
………

3. For how long have you been in your current work station the organization? (Tick as appropriate)

(a) Less than 1 year [ ]
(b) Between 1 and 5 years [ ]
(c) Between 6 and 10 years [ ]
(d) Between 11 and 15 years [ ]
(e) 16 years and above [ ]

SECTION II: FACTORS THAT AFFECT ACCESSIBILITY TO CREDIT SERVICES BY SMALL SCALE SUGAR CANE FARMERS IN BUNGOMA COUNTY

4. The main features of the lending policies of formal credit institutions that determine the access to and use of credit by small-scale sugar cane farmers in Kenya.

Listed below are some of the main features of the lending policies of formal credit institutions that determine the access to and use of credit by small and micro enterprises. Please indicate the extent to which each of the listed features determine lending policies the scale sugarcane farmers in Bungoma County by your institution (Tick as appropriate along a five point scale).

Where (Not at all = 1; Very little =2; Somehow = 3; Much = 4; and Very much = 5)

Features	**Response**				
	(1)	**(2)**	**(3)**	**(4)**	**(5)**
Loan Amounts - Prescribed minimum and maximum loan amounts					
Loan Applications - Complicated application procedures					
Restrictions on credit purposes - restriction of credit to specific activities, making it difficult to compensate for losses through other forms of enterprises					
Collateral - Stringent collateral requirements - use of traditional collateral like land.					
Loan administration difficulties - difficulties in loan administration like screening, monitoring and contract enforcement					
Transaction costs - high transaction costs					
Default risks - the risk of default					
Contract enforcement - poor contract enforcement mechanisms					
Customer information - imperfect information on creditworthiness					
Procedures - Over reliance on loan screening - reliance on project screening					
Loan processing – Delays and stringent requirements in loans processing and disbursement					
Loans disbursement procedures – Lack of clarity in procedures of loan disbursement, supervision and repayment					
Interest rates - High interest rates					
Credit duration – Unsuitable credit duration					
Terms of payment - Favorable terms of payment					
Supplementary services - The provision of supplementary services that fit in the needs of the target groups					
Travel costs - Travel costs and time are among other factors that determine transaction costs to the entrepreneurs					
Penalties - Penalties imposed on breach of contracts					
Size of transactions - Financial institutions' preference for large transactions					

5 The factors that determine the participation of small-scale sugar cane farmers in credit markets and their choice of credit sources in Kenya.

Listed below are some of the factors that determine participation of small-scale sugar cane farmers in credit markets and their choice of credit sources in Kenya. Please indicate the extent to which you agree/disagree that each of the listed factors determine the participation of small-scale sugar cane farmers in credit markets and their choice of credit sources with respect to your institution. (Please tick as appropriate along a five-point scale).

Where: (Strongly disagree= (1); Disagree = (**2**); Somehow agree = (**3**); Agree = (**4**); and strongly agree = (**5**))

Factors	**Response**				
	(1)	**(2)**	**(3)**	**(4)**	**(5)**
*5.1 **Enterprise Factors***					
Main occupation					
Household size					
Number of owners					
Revenue from the enterprise					
Income levels of applicants					
Distance to credit source					
Age of the enterprise					
Past credit participation and assets owned					
Others (specify)					
5.2 *Loan Terms and conditions imposed by lenders*					
Application fee					
Collateral value					
Application period					
Repayment period					
Other services provided with credit					
Whether credit is given for specific use.					
Others (Specify)					

6.0 What factors are considered when formulating your organizations credit policy to meet the credit needs of small scale sugarcane farmers in Kenya? (Please tick as appropriate along a five-point scale).

Where: (Not important at all = **(1);** A little important = **(2);** Important = **(3);** Very important = **(4);** critically important = **(5)**

	Response				
	(1)	**(2)**	**(3)**	**(4)**	**(5)**
Competitiveness in banking industry					
Geographical location					
Desired profit margins					
Desired market share					
Organizations cash requirement					
Others(specify)					

END