EFFECT OF FINANCIAL INTERMEDIARIES ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KAKAMEGA TOWN, KENYA

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A Thesis Submitted in Partial Fulfillment for the requirement for the award of the degree of Masters of Business Administration (Finance Option) of Masinde Muliro University of Science and Technology

March, 2016

DECLARATION

This thesis is my original work prepared with no other than the indicated sources and support and has not been presented elsewhere for a degree or any other award.

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CERTIFICATION

The undersigned certify that they have read and hereby recommend for acceptance of Masinde Muliro University of Science and Technology a thesis entitled **EFFECT OF FINANCIAL INTERMEDIARIES ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KAKAMEGA TOWN, KENYA**

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DEDICATION

I dedicate this research thesis to my family, Alex, Ian and Ivy.

ACKNOWLEDGEMENTS

First and foremost, I want to thank the Almighty God for giving me the opportunity to advance my studies, provided finances and gave me the strength to finish this research thesis. Special gratitude is to my supervisors Dr. Moses Poipoi and Mr. Peter Wawire for their guidance and constructive critiques throughout this process without outmost diligence, expertise and inspiration in the process of preparing this proposal. I would like to thank the Masinde Muliro University of Science and Technology Fraternity for providing the learning materials and professionals required for my research proposal. Further, gratitude goes to all my professional colleagues who in one way or another offered constant encouragement and support whenever I approached them. God bless them all.

ABSTRACT

Financial intermediation is one of the most important activities to any business enterprise globally. The primary objective of any business enterprise in its existence being profit and wealth maximization. In view of this, the effect of financial intermediaries are of great importance to emerging economies like Kenya. The general objective of this study was to determine the effect of financial intermediaries on the performance of small and medium enterprises in Kakamega Town, Kenya. Specifically, the study determined the effect of liquidity on the performance of small and medium enterprises, determined the effect of risk diversification on the performance of small and medium enterprises, determined the effect of pool saving on the performance small and medium enterprises and determined the moderating effect of organizational factors on the relationship between role of financial intermediaries and performance of small and medium enterprise. The study adopted a descriptive survey research design. The target population comprised of 4,149 small and medium enterprises from which 415 were randomly selected from the stratified groups. The study used both primary and secondary data collection instruments. Primary instruments included the use of questionnaires and interview schedules. Secondary instruments involved information from the small and medium enterprises and financial institutions. A pilot study to test reliability and validity of the research instruments was carried out in Bungoma County which is a neighboring county. The results of pilot study enabled some modifications of the research instruments where necessary after discussions with the supervisors. Reliability of the instruments was tested through use of Cronbach's Alpha coefficient of at least 0.70 which was acceptable implying that the instruments were reliable while the test -retest method was used to test validity. Descriptive statistics such as frequency, percentages, means and standard deviation were used to summarize the data and establish characteristics of the study population. Inferential statistics such as simple linear regression and correlation analysis were used to determine the relationship between the independent and dependent variable. The findings were presented using tables and charts. The study established that liquidity, risk diversification and pool savings have positive effect on the performance of small and medium enterprises. The results showed that 56.7% of small and medium enterprise performance can be explained by liquidity. 48.6% of small and medium enterprise performance can be explained by risk diversification and 53.4% of the performance can be explained by pool savings. It was therefore concluded liquidity greatly affected the performance of small and medium enterprises. The study thus recommends that organizations should aggressively engage in ensuring their business have enough cash cover, engage in different types of business to spread their risk, to actively engage in pool savings and to analysis the organizations factors since they have a positive moderating effect on the relationship between role of financial intermediaries and performance of small and medium enterprises. The outcome of this study contribute to existing pool of knowledge on embracing financial intermediaries by small and medium enterprises in enhancing their performance. To the management and policy makers, in decision regarding the regulation of Financial Intermediaries. Moreover, the findings of this study form a framework for further research in Kenya and the world in general by interested parties.

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LIST OF ABBREVIATIONS AND ACRONYMS

BBL: Biashara Boresha Loan

CBK: Central Bank of Kenya

GDP: Gross Domestic Product

GOK: Government of Kenya

KCB: Kenya commercial bank

NASDAQ National association of securities dealers automated quotations

NYCE New York current exchange

ROA: Return on Asset

ROK: Republic of Kenya

SME's: Small and Medium Enterprises

SPSS: Statistical Package for Social Sciences

OPERATIONAL DEFINITION OF TERMS

Capital base:	This is the capital structure of a company (shareholders' capital plus loans and retained earnings) used as way of assessing the company's worth
Financial intermediaries:	Refers to banks and other institutional investors Playing pivotal roles in transforming savings into investment, thereby facilitating liquidity, risk diversification, and pool saving.
Financial intermediation:	Refers to the process performed by banks of taking in funds from a depositor and then lending them out to a borrower.
Liquidity:	Liquidity is the ability to turn an asset into cash as well as the information about the price or the value of the investment.
Management style:	Characteristics ways of making decisions and relating to surbodinates
Number of employees:	They determine the size of the firm. These are the people hired by an employer to do a particular job. They are the staff of the organization
Organizational factors:	Refers to factors that affect an organization structure and development
Performance:	Refers to a subjective measure of how well a firm can use assets from its primary mode of business and generate revenue. It can also refer to a general measure of a firms

	overall financial health over a given period of time.
Performance of SME's:	Refers to the kind of relationship a firm enjoys within and outside its operating environment and how strong a company can reinvest its earnings. It can also refer to the ability of a firm to retain its employees for the longest time possible
Pool savings:	Refers to depositors being able to receive interest with minimal risk on their savings and they also have the freedom to change the finances into goods or services at any time they feel it is essential to do so.
Profitability:	High profits indicated a strong ability to reinvest earnings and compete heavily for market share in the business
Risk diversification:	Refers to a risk management technique that mixes wide variety of investments within a portfolio which on average yield higher return and pose a lower risk than any individual investment found within the portfolio.
Small and medium enterprise:	Is defined on the basis of their characteristics that include size of capital, investment, number of employees, turnover, management behaviour, location and market share but very commonly is number of employees in the enterprise of about 10- 250 employees.
Staff turnover:	Refers to the rate at which employees are leaving the organization per year.

CHAPTER ONE:
INTRODUCTION

1.1 Introduction

This chapter describes the background to the study, statement of the research problem, purpose of the study and the specific objectives of the study. The chapter also will capture the research questions, hypotheses, significance, scope and conceptual framework.

1.2 Background to the Study

In recent years, the link between financial intermediaries and economic growth has generated a great deal of interest among policymakers, academics, and economists in developing countries. Several studies have been carried out on the relationship between financial developments and economic growth in developed countries (Levine, 1997).

According to Aziakpono (2005) financial intermediation plays a significant role in increasing economic activities of an economy through the following functions. Firstly, financial systems act as an effective conduit for channeling funds from surplus to deficit units by mobilizing resources and ensuring an efficient transformation of funds into the real productive sector of an economy. Secondly, financial intermediation leads to the transformation of the maturity of savers and investors' portfolios, thus, providing sufficient liquidity to the system as the need arises. The third important role is risks reduction from the system through diversification and techniques of risk sharing and pooling.

Financial intermediation is an exciting field in the demand and supply of funds for investment, liquidity and consumption purposes. Through financial intermediation economic growth occurs and the improvement of the welfare improves: Funds are routed from the savers to borrowers who use the funds in most profitable economic activities (King & Levine 1993). Financial intermediation can be described as the process performed by financial intermediaries of collecting savings and deposits from savers and depositors' and lending out the same to borrowers. According to Gorton & Winton (2002), financial intermediation is the root institution in the savings-investment process.

According OECD (2001), in financial intermediation a financial institution will engage in financial transactions on behalf of lenders and savers in a specialized market i.e. a financial market e.g. stock exchange market, banking sector and in the money market. The institution will therefore expose itself to the risk of losing money on behalf of the lenders/saver by lending the same to borrowers; thus the role of financial intermediaries therefore is to channel funds from lenders to borrowers by intermediating between them.

According to the State University of New York (2014), financial intermediaries performs the following functions: Pooling the resources of small savers; many borrowers require large sums, while many savers offer small sums. Without intermediaries the borrowers of large credit would be disadvantaged as they would incur huge costs of looking for savers who would provide the needed amount to be borrowed. Providing safekeeping, accounting, and payments mechanisms for resources; banks are a good example for the safekeeping of money in accounts, the records of payments, deposits and withdrawals and the use of

debit/ATM cards and checks as payment mechanisms. Providing liquidity, liquidity refers to how easily and cheaply an asset can be converted to a means of payment. Financial intermediaries make is easy to transform various assets into a means of payment through ATMs, checking accounts, and debit cards. Diversifying risk; financial intermediaries help investors diversify in ways they would be unable to do on their own. When a financial intermediary wants to loan someone it minimizes the risk by securing the debt as compared to an individual offering a loan to someone. Collecting and processing information; financial intermediaries are experts at collecting and processing information in order to accurately gauge the risk of various investments and to price them accordingly. This can be seen in the pricing of loans, investment products and other financial products offered by the intermediaries.

King and Levine (1993), financial development is a good predictor of future growth; financial growth can be well described by the growth of financial intermediaries and financial innovations i.e. securitization (a process where mere assets are converted to a tradable position on the money markets) which are active in the financial intermediation process.

Performance of SMEs

The number of small and medium enterprises is growing rapidly in Kenya (Sessional paper 2005, World Bank report). Every sector has smaller operations, this include the textile industry, finance, manufacturing, security, transport services, food and hotels to mention a few. The SMEs sector accounts for 75% of the total employment in Kenya while contributing 18.4 percent of the country's Gross Domestic Product. According to GOK

(2009), in the recent years the performance of the SMEs has continued to decline in Kenya. Virtually most small enterprises had collapsed leading to the closure of some of the SMEs that were producing 40% of the employment in Kenya. Other SMEs were auctioned while some were merged or acquired signifying questionable financial performance due to lack of proper management of debt acquired.

The importance of SMEs in Kenya was first recognized in the International Labor Organization report on „Employment, Income and Equity in Kenya" in 1972. The report underscored SMEs as an engine for employment and income growth. SMEs create about 85 percent of Kenya's employment (African Economic Outlook, 2011 report). Access to credit is still a challenge to most SMEs, especially those in developing economies and it is also still a key issue both within the private and public sector. In Kenya, the lack of adequate access to credit is the leading factor stifling the growth of small and medium enterprises (Wanjohi & Mugure, 2008).

In Kakamega County, Nganda, Wanyonyi & Kitili (2014) indicated that there was a marginal weak association between financial factors and growth of SMEs. Therefore, checks on the financial factors could lead to growth of SMEs, for example, reduction in interest rates by both commercial banks and micro financial institutions. Correlational results between law and regulations on growth of SMEs do indicate that income taxes and collection of revenues from the government hamper the running of the business, thus, slowing the growth of the SMEs. This research proposal deeply examined how role of

financial intermediaries affected the performance of SME's in an emerging economy, Kenya.

1.3 Statement of the Problem

The World Bank report (2010) suggests that one of the major causes of SME failure is limited access to external finance. The report further observes that SME loans as a percentage of total bank loans are generally smaller compared to large firms. Approximately ten percent (10%) of all formal SMEs have access to a bank credit line. They are in turn hampered by the lack of lender information and regulatory support to engage in SME lending. The overall result is absence of a well-functioning SME lending market, and SME are impended in their growth and performance with negative consequence for innovation, economic growth and macro-economic resilience in developing countries (Dalberg, 2011). Finance is the life-blood of any business enterprise and no enterprise, no matter how well managed, can survive without enough funds for working capital, fixed assets investment, employment of skilled employees and development of markets and new products (Agnew, 2003). Therefore, access to finance is essential to the survival and performance of any business.

This study assessed the effect of Financial Intermediaries on the performance of Small and Medium Enterprises (SMEs) with a special focus on SMEs in Kakamega town. It is about providing the poor with a starting point that can enable them to enjoy the fruitfulness of economic growth. Inclusive growth mirrors the teaching of Mahatma Gandhi that developing nations cannot develop via mass production but by production by the masses. One of the surest routes to production by the masses is an entrepreneurship (Atieno, 2001)

Although, a considerable number of research reports have mentioned the access to finance has been a major problem in the SME sector, for instance muguchu (2010) established relationship between access to credit and financial performance of SMEs in Nairobi, whereas Mwania (2011) established the effect of Biashara Boresha Loan (BBL) on Performance of Micro and Small enterprises owned by Kenya Commercial Bank (KCB) Ruiru branch. A survey of literature dealing with this area indicates there is a significant gap in knowledge on the effect of financial intermediaries on the performance of SMEs. Thus, this study sought to address the research question; what is the effect of financial intermediaries on the performance of small and medium enterprise in Kakamega town?

1.4 General Objective

The study aimed at determining the effect of financial intermediaries on performance of SME's in Kakamega Town, Kenya.

1.5 Specific Objectives

The specific objectives of the study were:

i. To determine the effect of liquidity on the performance of SME's.

ii. To determine the effect of risk diversification on the performance of SME's.

iii. To determine the effect of pool saving on the performance SME's.

iv. To determine the moderating effect of organizational factors on the relationship between the role of financial intermediaries and performance of SME's,

1.6 Hypothesis

The hypotheses of the study were:

H01: There is no effect of liquidity on performance of SMEs.

H02: There is no effect of risk diversification on performance of SMEs

H03: There is no effect of pool savings on performance of SMEs.

H04: There is no effect of organizational factors as a moderating factors on performance of SMEs

1.7 Significance of the Study

The Government ministries and department collect taxes and spend public funds to meet their recurrent and development projects and program needs. In view of this, the Government will benefit a lot since the SME's are empowered through financial intermediation hence better performance, consequently income to the Government in form of tax collected from them. The government can also use the findings of the study in implementation of its strategies and economic policies. The Central Bank of Kenya (CBK) plays as a regulatory body in the management of financial intermediaries. It regulates the lending rates and offers licenses on the financial institutions that would wish to operate financial services in Kenya.

Literature review will be developed in that the results for meda basis for researchers to make reference on. The study will build on the local literature on effect of financial intermediaries and performance of SMEs. Although most studies done have focused on the challenges faced by SME traders, this study will focus on the effects of financial intermediaries and how they affect the performance of SMEs. The impact of liquidity, risk diversification and pool savings are yet to be studied as a single intervention in a rural setting. The scarce availability of reliable and valid data continues to be one of the key obstacles in understanding small and medium enterprises in the rural Kenya and the data

to be generated would be used to build on literature and advice on policies governing SMEs.

Further, the findings of the study will be useful to all those who are involved in the ownership and management of SME's in Kenya. The owners will be able to make use of financial intermediaries to boost the performance of their businesses. The managers of financial institutions will also benefit from this information by having clear guidelines on how to embrace financial intermediation to benefit their institutions.

The general public will be informed of the various approaches in which an entity can embrace financial intermediaries aimed at improving on the quality of work in the work place and generally giving back to society. This will lead to increased human benefit and satisfaction through quality services and goods.

The study will add knowledge to the existing body of research relating to financial intermediaries and Business Performance in Kenya and other developing economies in Africa.

1.8 Scope of the Study

The study area was Kakamega town, targeting all the SMEs in the county. The study determined the effect of financial intermediaries in Kakamega Town in enhancing performance of 4149 SME's as long as they were operational as from 2011 to 2014. The period was chosen due to the availability of financials (books of account) that were to be used in the study. The employees of the SMEs were targeted, for purposes of neutrality. The constructs on the conceptual frame work was limited to the dependent and independent variables.

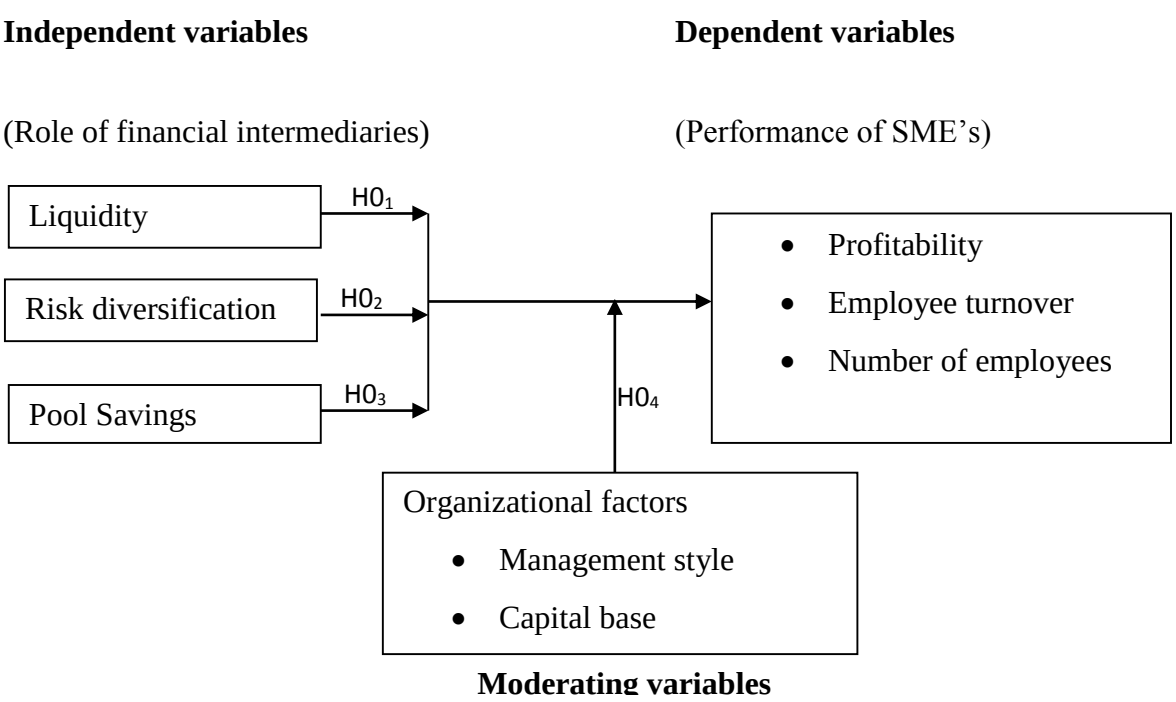
1.9 Limitations of the Study

Getting access to some information and reaching the targeted interviewee was hard. Some of the interviewee were not fully conversant with the study. The researcher however met the interviewee during their free time to clarify on any questionnaires' question to clear to the respondents.

The respondents lacked trust and thus hide information crucial for the study from the researcher. To overcome this, the researcher assured them that the information was only confidential and would not be released to competitors. In addition, the SME's subjected their views due to biasness because they were aware that the information generated from the study was useful to them. The researcher overcame this by citing other existing literature information on the area of study. The findings of the study were influenced by the researcher's subjectivity. The researcher addressed this through citing literary sources to support personal views to minimize subjectivity.

1.10: Conceptual Framework

Figure 1.1



Source: Researcher's own conceptualization 2014

The study filled the knowledge gap by determining the role of financial intermediaries on the performance of SME's in Kakamega Town. Services carried out by financial intermediaries include pooling together of savings, risk diversification, liquidity and provision of information services. Liquidity is the ability to turn an asset into cash as well as the information about the price or the value of the investment. Liquidity management enhances operating performance and is usually associated with higher corporate values. Risk diversification is a risk management technique that mixes a wide variety of investments within a portfolio which on average yield higher return and pose a lower risk than any individual investment found within the portfolio. Investing in a variety of

companies within that class can help counteract nonsystematic risk which is based on the performance of a company. Pool saving involves depositors being able to receive interest with minimal risk on their savings and they also have the freedom to change the finances into goods or services at any time they feel it is essential to do so. Management style that focuses on managers as coaches, counselors, facilitators and team leaders have resulted to team building, network of relationships developing and motivating others. This is a quick cure for poor morale and low productivity. Capital base provides a benchmark when measuring returns. Without it, SMEs would be unaware of how they are doing relative to their investments.

CHAPTER TWO:
LITERATURE REVIEW

2.1 Introduction

This chapter is devoted to the review of literature. The general overview, theoretical framework; the perfect model, information asymmetry argument theory, transaction cost theory regulation of money production and delegated theory are discussed in this chapter. Determinants of performance of SMEs are also discussed in this chapter. Empirical review is also highlighted.

2.2 General overview

Schumpeter (1911) was among the pioneers on the nexus between financial intermediation and economic growth. He put forward an argument as to whether the financial sector of an economy can lead to economic growth, or it is the rapid industrialization that leads to the development of financial intermediaries. To Joan Robinson, it is when economic growth leads that financial development follows. However, Goldsmith (1969) emphasized that sound financial sector can play a significant role in increasing economic activities.

McKinnon (1973) and Shaw (1973) were the first to explicate the notion of financial repression. According to this notion, a repressed financial sector discourages both saving and investment because the rates of return are lower than what could be available in a competitive market. In such a system, financial intermediaries fail to operate at it full capacity in promoting saving and investment thus, this impeding the development of the overall economic system. This finding was based on the theoretical grounds of the liquidity

preference theory propagated by Keynes (1936) who believed that interest rates had to be lowered to avoid a fall in income. During the 1980s, many developing countries faced economic instability and high inflation rate. This led Neo structuralisms such as Stiglitz (1989) to criticize the McKinnon-Shaw school and concluded that financial liberalization would only slow down the growth.

A different strand of the theory that positively links finance and growth emerged in the early 1990s as a branch of the literature of endogenous growth. Many studies depend on the model structure of the AK type (Romer, 1986), in the sense that there are constant returns to a sufficiently broad concept of capital. Bencivenga &Smith (1991) present a model in which savings are channeled to promote productive activities. Through this investors adjust their assets towards the illiquid growth enhancing. King & Levine (1993b) developed a Schumpeterian model of technological progress similar to Romer (1990). Financial intermediaries and securities markets enable particular entrepreneurs to undertake an innovative activity, which affects growth through productivity enhancement this is also similar to the view of Schumpeter (cited above). Bencivenga, Smith, & Starr (1995) indicate that financial institutions lower liquidity risk to which savers are exposed by enabling depositors to withdraw cash before a project's maturity (banks). This reduces the disincentive to investing in long run projects

2.3 Theoretical framework

There are several theories that explain the existence of financial intermediation. These theories are as discussed below.

2.3.1 The Perfect Model

Three pillars are at the basis of the modern theory of finance: optimality, arbitrage, and equilibrium. Optimality referred to the notion that rational investors aimed at optimal returns. Arbitrage implied that the same asset had the same price in each single period in the absence of restrictions. McKenzie (1959) found out that Equilibrium meant that markets were cleared by price adjustment – through arbitrage – at each moment in time.

In the neoclassical model of a perfect market, the perfect market for capital, or the Arrow-Debreu world, the following criteria was met: no individual party on the market could influence prices; conditions for borrowing/lending are equal for all parties under equal circumstances; there were no discriminatory taxes; absence of scale and scope economies; all financial titles were homogeneous, divisible and tradable; there were no information costs, no transaction costs and no insolvency ; costs; all market parties had ex ante and ex post immediate and full information; on all factors and events relevant for the (future) value of the traded financial instruments (Arrow & Debreu, 1954).

The 'Arrow-Debreu world' was based on the paradigm of complete markets. In the case of complete markets, present value prices of investment projects were well defined. Savers and investors found each other because they had perfect information on each other's preferences at no cost in order to exchange savings against readily available financial instruments. These instruments were constructed and traded causelessly and they fully and

simultaneously met the needs of both savers and investors. Thus, each possible future state of the world was fully covered by a so-called Arrow-Debreu security (state contingent claim) (Arrow & Debreu, 1954)

Also important was that the supply of capital instruments was sufficiently diversified as to provide the possibility of full risk diversification and, thanks to complete information, market parties had homogenous expectations and acted rationally. In so far as this does not occur naturally, intermediaries were useful to bring savers and investors together and to create instruments that met their needs. They did so with reimbursement of costs, but costs were by definition an element – or, rather, characteristic – of market imperfection (Ross, 1976)

2.3.2 Informational Asymmetries Argument

These asymmetries could be of an ex-ante nature, generating adverse selection, they could be interim, generating moral hazard, and they could be of annex-post-nature, resulting in auditing or costly state verification and enforcement. The informational asymmetries generated market imperfections, i.e. deviations from the neo-classical framework. Many of these imperfections led to specific forms of transaction costs. Financial intermediaries appear to overcome these costs, at least partially. For example, Diamond & Dybvig (1983) considered banks as coalitions of depositors that provided households with insurance against idiosyncratic shocks that adversely affected their liquidity position.

They interpreted financial intermediaries as information sharing coalitions. Diamond (1984) showed that these intermediary coalitions could achieve economies of scale.

Diamond (1984) was of the view that financial intermediaries acted as delegated monitors on behalf of ultimate savers. Monitoring would involve increasing returns to scale, which implied that specializing may be attractive. Individual households would delegate the monitoring activity to such a specialist, that is, to the financial intermediary. The households would put their deposits with the intermediary. They would withdraw the deposits in order to discipline the intermediary in their monitoring function. Furthermore, they would positively value the intermediary's involvement in the ultimate investment (Hart, 1995). There could be assigned a positive incentive effect of short-term debt, and in particular deposits, on bankers (Hart & Moore, 1995).

Liquid assets of the bank resulted in a fragile financial structure that is essential for disciplining the bank manager. Note that in the case households that did not turn to intermediated finance but prefer direct finance, there is still a "brokerage" role for financial intermediaries, such as investment banks (Baron, 1982). Here, the reputation effect was also at stake. In financing, both the reputation of the borrower and that of the financier were relevant (Hart & Moore, 1998). Dinç (2000) studied the effects of financial market competition on a bank reputation mechanism, and argued that the incentive for the bank to keep its commitment is derived from its reputation, the number of competing banks and their reputation, and the competition from bond markets. These four aspects clearly interacted (Boot, Greenbaum & Thakor, 1993).

The "informational asymmetry" studies focused on the bank/borrower and the bank/lender relation in particular. In bank lending one could basically distinguish transactions-based

lending (financial statement lending, asset-based lending, credit scoring, etc) and relationship lending. In the former class information that was relatively easily available at the time of loan origination was used. In the latter class, data gathered over the course of the relationship with the borrower was used (Berger & Udell, 2002). Central themes in the bank/borrower relation were the screening and monitoring function of banks (ex- ante information asymmetries), the adverse selection problem (Akerlof, 1970), credit rationing (Stiglitz & Weiss, 1981), the moral hazard problem (Stiglitz & Weiss, 1983) and the ex post verification problem (Gale & Hellwig,1985). Central themes in the bank/lender relation were bank runs, why they occurred, how they could be prevented, and their economic consequences (Bernanke, 1983); Another avenue in the bank/lender relationship was models for competition between banks for deposits in relation to their lending policy and the probability that they fulfilled their obligations (Boot, 2000); (Diamond & Rajan, 2001).

According to Nayyar (1990), information asymmetries are considered to as leading costs to both the buyers and sellers in an exchange situation. Thus the existence of information asymmetry can lead to either of the party being at an advantageous position and the other at a losing situation. This will arise due to one party having access to superior information as compared to the other party and vice versa. The existence of the asymmetrical information can lead the market to break down or perform inefficiently as the information advantaged group can take advantage of the information deprived group. Information asymmetries usually lead to higher prices in order to access the services, there's a concerted effort aiming to reduce the cost accessing such services thus the need of financial intermediation. Problems that may arise due to information asymmetries include moral

hazard, adverse selection and information monopoly. Adverse selection occurs when the wrong type of persons are selected for a transaction in the case of financial intermediation. They may be customers with bad credit risk or persons who are considered to have a low or a negative level of credit worthiness. Financial intermediaries are able to assess the credit risk that a customer brings with the loans/finances borrowed. Moral hazard arises when the borrower uses the funds borrowed for a non-profitable activity that would likely lead to a difficulty in paying.

Financial intermediaries are able to mitigate the above through negotiations and binding contractual agreements so as to protect their position. Moral hazard has often hampered the flow of information between the market players thus creating inefficiencies in the market (Nayyar, 1990). The current financial intermediation theory builds on the view that the existence of financial intermediaries is to reduce the transactional costs and informational asymmetries. Many of the transactional costs of financial intermediation are usually the end result of asymmetrical information.

2.3.3 Transaction Cost Approach

In contrast to the first, this approach did not contradict the assumption of complete markets. It was based on non-convexities in transaction technologies. Here, the financial intermediaries acted as coalitions of individual lenders or borrowers who exploited economies of scale or scope in the transaction technology. (Fama, 1980).

The notion of transaction costs encompassed not only exchange or monetary transaction costs (Tobin, 1963), but also search costs and monitoring and auditing costs (Benston &

Smith, 1976). Here, the role of the financial intermediaries was to transform particular financial claims into other types of claims (so-called qualitative asset transformation). As such, according to Pyle (1971) they offered liquidity and according to Hellwig (1991) diversification opportunities were offered. The provision of liquidity was a key function for savers and investors and increasingly for corporate customers, whereas the provision of diversification increasingly was being appreciated in personal and institutional financing. Holmström & Tirole (2001) suggested that this liquidity should play a key role in asset pricing theory.

The result was that unique characteristics of bank loans emerging to enhance efficiency between borrower and lender. In loan contract design, it was the urge to be able to efficiently bargain in later (re)negotiations, rather than to fully assess current or expected default risk that structured the ultimate contract (Gorton & Kahn, 2000). With transaction costs, and in contrast to the information asymmetry approach, the reason for the existence of financial intermediaries, namely transaction costs was exogenous. This was not fully the case in the third approach.

Benston & Smith (1976) interpreted transactional costs as the transportation costs, administration cost, searching, evaluation and monitoring in regard to financial transactions. Thus the financial intermediaries bear these costs on behalf of the suppliers of funds (lenders/savers). Financial intermediaries are able to reduce this cost due to the economies of scale that they have due to the large number of customers that they serve in the intermediation process. Financial intermediaries exist due to the following reasons;

high cost of transactions (the cost of marriage between the lenders and borrowers); lack of complete information (information asymmetry) and the method of regulation.

2.3.4 Regulation of Money Production Approach

The other approach that explained the financial intermediaries was based on the regulation of money production and of saving in and financing of the economy (Guttentag & Lindsay, 1968). Regulation affected solvency and liquidity with the financial institution. Diamond & Rajan (2000) showed that bank capital affected bank safety, the bank's ability to re-finance, and the bank's ability to extract repayment from borrowers or its willingness to liquidate them.

The legal-based view especially saw regulation as a crucial factor that shaped the financial economy (La Porta, Lopez-De-Silanes, Shleifer, & Vishny, 1998). Many viewed financial regulations as something that was completely exogenous to the financial industry. However, the activities of the intermediaries inherently "ask for regulation". This was because they, the banks in particular, by the way and the art of their activities (Qualitative asset transformation), were inherently insolvent and illiquid (for the example of deposit insurance, (Merton & Bodie, 1993). Furthermore, money and its value, the key raw material of the financial services industry, to a large extent was both defined and determined by the nation state, i.e. by regulating authorities par excellence. Safety and soundness of the financial system as a whole and the enactment of industrial, financial and fiscal policies were regarded as the main reasons to regulate the financial industry (Kareken, 1986; Goodhart, 1987; Boot & Thakor, 1993). Also, the financial history

showed a clear interplay between financial institutions and markets and the regulators, be if the present-day specialized financial supervisors or the old-fashioned sovereigns (Kindleberger, 1993).

Regulation of financial intermediaries, especially of banks, was costly. There were the direct costs of administration and of employing the supervisors, and there were the indirect costs of the distortions generated by monetary and prudential supervision. Regulation however, generated rents for the regulated financial intermediaries, since it hampered market entry as well as exit. So, there was a true dynamic relationship between regulation and financial production. It must be noted that, once again, most of the literature in this category focused on explaining the functioning of the financial intermediary with regulation as an exogenous force. Kane (1977) and Fohlin (2000) attempted to develop theories that explained the existence of the very extensive regulation of financial intermediaries when they went into the dynamics of financial regulation.

The method of regulation influences liquidity and solvability of intermediaries. Diamond & Rajan, (2000) show that the regulation regarding the capital of intermediaries influence their 'health', the ability for refinancing and for recovering debts.

2.3.5 Delegated Theory

The theory of Delegated monitoring Delegation is brought about by this basic question, why do savers/households give money to financial intermediaries and the intermediaries loan the same to borrowers/investors? The theory of delegated monitoring is one of the major Explanations why financial intermediaries exist. The theory largely revolves around

the collection of information regarding an individual or an institution before a financial transaction is done, this is done especially during the process of issuance of loans and securities. Delegated monitoring revolves to the idea that savers are professionally and time deficient to monitor institutional and individual borrowers for default risk. Default risk is the likelihood of a borrower not to honor repayment on a debt borrowed/a debt contract signed. Also borrowers are most likely to hide information thus the need for monitoring (diamond 1984).

According to Diamond (1996), Financial intermediaries are agents, or groups of agents, who are delegated the authority to invest in financial assets on behalf of households/savers. The cost of monitoring and enforcing debt contracts issued directly to investors (equity) is a reason that raising funds through an intermediary can be superior. The easiest way to lower the cost of information in the delegated theory is to acquire unmonitored debt and to disburse the same to borrowers. The unmonitored debt is usually in the form of deposits from households held by the financial intermediaries e.g. Sacco's, banks and other financial institutions that provide loans/funds for the investment process. Financial intermediaries have profited from the role of collecting information that they use in disbursing private loans as compared to purchasing already securitized debts in the financial markets (the stock exchange).One of the most important things in delegated monitoring is the analysis of benefits and costs associated with the same. Monitoring involves increasing returns to scale which implies that it will be best done by a profession i.e. an intermediary. The collection of private information by the financial intermediaries will benefit them as the information can be used in lending. Though it's usually hard to

verify if the monitoring has been done or not. Delegated monitoring pays off when its cost is equal or less than the cost of contracting without monitoring and the cost of direct monitoring.

According to Gastineau (1996) delegated monitoring is a commercial banking function that involves collecting and analyzing information about the investments and obligations of borrowers to evaluate their ongoing creditworthiness for their own risk management purposes and as a supplement to risk management by their borrowers. Financial intermediaries reduce the degree of information imperfection and asymmetry between the ultimate suppliers and users of funds. The cost of collection of information regarding financial transactions for savers is costly and thus that function is usually delegated to the financial intermediaries. A failure to do so would expose the investor to agency costs, which relate to the risk that the owners and/or managers of the firm will take actions that are contrary to the interests of the investor. Such agency costs arise whenever economic agents enter into contracts in a situation of incomplete information and thus costly information collection. The common solution to the problem of incomplete information is for the households to pool their resources i.e. savings into a financial institution that will invest directly in another corporation/invest in activities that bring in better returns. Saccos have always pooled resources through the monthly member contributions that are used to issue loans and also invest in other economic activities.

2.4 Roles of Financial Intermediaries

These are services offered by banks and other institutional investors playing pivotal roles in transforming savings into investment, thereby facilitating liquidity, risk diversification, and pool saving.

2.4.1 Effect of Risk Diversification on performance of SMEs

Low transaction costs enabled financial intermediaries to share risks through asset transformation; the process by which financial intermediaries turned risky assets into safer assets for investors by selling and creating assets, which had lower risks and in turn buy the assets associated with more risks. The financial intermediaries assisted persons as well as business in diversifying their asset holdings, by buying a wide range of assets which they grouped and then sold the rights of the diversified groups to individuals (Focardi & Fabozzi, 2004; Allen & Gale, 1999).

Investors offered financial intermediaries directives on investment of funds, at a fee and as a result, the financial intermediaries shared the risks associated with such investments with the investor. In so doing, the financial intermediaries were able to conduct market analysis so as to determine the best investment opportunity and therefore, profits or losses arising from the investment were shared by both the investor and the financial intermediary. By agreeing to share the risks in investments, financial intermediaries benefitted from the deal by making considerable profits from successful investments. The investors benefitted from engaging the financial intermediaries since they were relieved of fears in undertaking particular investments, and bearing all the costs for undertaking such investments. They also benefitted from the professionalism from the financial

intermediary, which assures them of the possible success of their investments (Fecht, Huang & Martin, 2008).

Kwanum (2012), in Nigeria found out that 84% of SMEs did not cover their business against risk. Another study by ICEAW by Virdi (2005) reported that about half of SMEs have no risk management procedures in place. Risk management is not totally embedded in SMEs and the ability to withstand this risk is less than that of large firms. Kagwathi, Kamau & Njau (2014) found out that many entrepreneurs lack a wide global view of business, low level of exposure, ignorance and inability to apply modern technology in their business. However the study by Kagwathi et al. (2014) carried out the study in an urban town, Nairobi, and used the results to come to conclusion that all SMEs in Kenya face a major challenge when it comes to risk diversification.

2.4.2 Effect of Liquidity on performance of SMEs

This is the ability of financial institutions to meet their cash and collateral obligation without incurring unacceptable losses. Financial markets share a critical element in the economy. They include bonds, foreign exchange, and stock markets. Financial markets directed the flow of funds from savers to investors, by bringing buyers and sellers together, therefore affecting the wealth of individuals and how businesses behave, and the entire economy. In so doing, financial markets facilitated economic efficiency, and economic growth. Funds could be transferred by the financial market from savers to borrowers through direct transfers, investment bankers or use of intermediaries (Melicher & Norton, 2011).

Liquidity management is necessary for all businesses, small, medium or large. Because, it means collecting cash from customers in time to ensure no difficulty in paying short term debts. Therefore, when a business does not manage its liquidity well, it will have cash shortages and will result in difficulty in paying obligations. In this regard Ali Uyar (2009) opines that, in addition to profitability, liquidity management is vital for ongoing concern. Schilling (1996) suggests optimum liquidity position, which is minimum level of liquidity necessary to support a given level of business activity. He says it is critical to deploy resources between working capital and capital investment, because the return on investment is usually less than the return on working capital investment. Therefore, deploying resources on working capital as much as to maintain optimum liquidity position is necessary. Then he sets up the relationship between conversion cycle and minimum liquidity required such that if the cycle lengthens, the minimum liquidity required increases, and vice versa.

In the US Primary Market, fresh security issues were sold to the primary buyers, and mainly involved investment banks offering such issues. The secondary market was a market through which previously issued securities were sold and bought for example the NYCE and the NASDAQ. The secondary markets offered liquidity in the market, facilitated swap of securities between buyers and sellers. The secondary market in addition was to setup the prices for the securities (Megginson & Smart, 2008). Financial markets assisted in the production of well-organized capital allocations, hence allowed transfer of funds from individuals who did not have fruitful investment opportunities, to the individuals who had them. Buyers were also able to progress their lifestyles and business

since they had available information which allowed them to settle on the best time to make purchases (Brigham & Houston, 2009).

A study by Muguchu (2010), indicated that lack of access to credit is one of the main constraints and a number of factors have been identified to explain this problem. The study however ignored the fact that finance alone cannot make entrepreneurs successful. It must be in uniformity with the person's will to succeed in business and the training in the field in which the enterprise is set. The above studies ignore the aspect of other services offered by financial intermediaries. SMEs continue to be hailed as a huge employer in the Kenyan economy. However, the entrepreneurs still continue to languish in poverty since most of them do the businesses for their survival. Many SMEs though operational stagnate at one stage for many years, performing dismally and employing only the owner. This means that such SMEs die when the owners die. No legacy and perpetuity is expected when performance in these SMEs are negligible.

2.4.3 Effect of Pool Savings on performance of SMEs

Financial intermediaries made their earnings through the reduction of transaction costs through the development of proficiency and by taking advantage of economies of scale. Low transaction costs meant that the financial intermediaries were able to provide liquidity services to clientele enabling the clientele to conduct transactions easier. Depositors were also able to receive interest on their savings and checking accounts, and they also had the freedom to change the finances into goods or services at any time they feel it is essential to do so (Buckle & Thompson, 2004); (Köppl, 2006). Transaction costs include both search costs as well as negotiation costs. Search costs are the costs incurred by the financial

intermediary while they searched for finances as well as the costs incurred by the savers while they searched for the most efficient financial intermediary who would effectively manage their investment plans.

Negotiation costs were incurred during the negotiation between the investors and the financial intermediaries on the best ways of investment and also included the expenses of administration and conduction of the actual transactions both by the investor and the intermediary (Cecchetti, 1999). Apart from mobilizing capital resources, financial intermediaries increased returns to the savers through reduction of transaction costs. Although interests charged on savings was elastic due to the market conditions, intermediaries increased the returns of their clients through adoption of the latest technology, which facilitated lower negotiation as well as searched the benefits of the savers and the financial intermediary (Buckle & Thompson, 1998).

2.5 Performance of SME

This is the kind of relationship a firm enjoyed within and outside its operating environment and how strong a company could reinvest its earnings. It could also refer to the ability of a firm to retain its employees for the longest time possible

2.5.1 Profitability

Profitability is both an internal metric and a benchmark. High profits indicated a strong ability to reinvest earnings and compete heavily for market share in the business environment (Rayport & Jaworski, 2001). According to Rayport & Jaworski (2001), return on investment (ROI) was a measurement that reviewed the profitability for various projects in which a company engaged. The classic formula here was investment gain less

investment cost divided by investment cost. Companies could typically use this as a pre-project profitability measurement as they looked to find the most profitable projects among several options. In most cases, companies' desired selection of the most profitable projects as these would add to the bottom line and not create a dragon company resource.

Profits are necessary for survival in the long run in a competitive environment, but SME management may choose not to grow. Long-term profitability derives from the relations between cost and revenue; it is a necessary but not sufficient condition for growth. Revenues may be held up by entry barriers and costs pushed down by management ingenuity. A low-profit firm will lack the finance for expansion, but a high-profit business may conclude the risk and rewards of expansion are inadequate. In a 'life style' SME, an owner may trade profitability today against profitability tomorrow. Dynamic pricing or sequential investment projects may require initially lower profits in order to obtain higher future pay-offs from greater market penetration. An SME manager's time preference is likely to determine the inter-temporal profit trade-off, (Foreman-Peck, Makepeace & Morgan, 2006)

In short, there was really no end to the methods available when measuring profit. The company simply assessed the formula against the need and selects the appropriate profitability measure (Brown, 2003).

2.5.2 Employee Turnover

According to Butali, Wesang'ula & Mamuli (2013) Staff turnover negatively affected customer satisfaction. Services rendered to customers were interfered with whenever staff

left an organization. Tyson and Fell (1986) observed that in the event that a member of staff left an organization, customers were among the first to know that work was not being done well. In some cases, those who took the job of those who exited were not so efficient or not so familiar with the procedures of the organization. The slow rate of services to the customers lowered customer satisfaction levels and thus spoilt the reputation of the organization.

Staff turnover in organization brought about decreased incomes due to reduced productivity. Productivity went low due to reduced efficiency of the operations. In conclusion staff turnover had negative financial effects on the organization, (Butali et al., 2013). This observation went in line with Armstrong and Baron (2005) who argued that high employee turnover brought about decreased income due to reduced productivity.

2.5.3 Number of Employees

The size of a firm played an important role in determining the kind of relationship the firm enjoyed within and outside its operating environment. In this study, the size of a firm was defined by the number of employees.

A positive relationship between size of the firm and performance was found by Vijayakumar & Tamizhselvan (2010), in their study after dividing firms into four sizes, established that a firm's profitability is positively influenced by the firm size. The theoretical relationship between size and investments helped to explain why, large firms

were more leveraged. Large firms had higher investment opportunities and so should also have higher need for cash) than smaller firms, (Dittmer, 2004,).

Pervan & Josipa (2012) indicated that larger firms have more market power that provides them with possibility to charge high price and earn high profits. A relative bigger firm is expected to cope better with change and it has better chances to offset random losses due to market uncertainties bigger firms have lower riskiness. Small firms often suffer from borrowing constraints; however they may not require large amounts of capital, thereafter the capital constraints might not be severe as the firm grows.

Thorsten & Brigham (2008) argued that largest firms were completely unaffected by collateral requirements, bank bureaucracies, the need for special connections (probably because they already had them), banks' lack of money, or any of the access issues. In contrast, medium-sized firms, and particularly small firms, were significantly and negatively affected by collateral requirements, bank paperwork and bureaucracy, high interest rates, the need for special connections with banks, banks' lack of money to lend, and access to financing for leasing equipment. The smallest firms were also negatively affected by obstacles to gaining access to finance. The tests for the difference in the economic impact of specific financing obstacles on the largest and smallest firms confirmed significant differences for most of the obstacles that significantly affected the growth of small firms. These results provided evidence that financial obstacles could have a much greater impact on the operation and growth of small firms than on that of large.

2.6 Organizational Factors

This describes the factors that affect an organization structure and development.

2.6.1 Management Style

According to Cheong (2010) there are various styles of management which include Autocratic, Democratic, Participative, and Laissez Faire,. An autocratic manager made decisions without consultations, they dictated and liked being in control of situations. This style of management lead to work getting done on time because there were less people involved in the decision making process and was best where on the spot decisions needed. Cheong (2010), the problem with this style was that staffs were not motivated and employees' turnover was high. A democratic manager delegates work to his staff. Since many people are involved in decision making, the work was slow according to Cheong (2010). In a democratic style, the manager allowed the employees to take part in decision-making: therefore everything was agreed upon by the majority.

Consultative/Participative Management Style involved getting lots of feedback from one's staff before coming to a conclusion and making a decision. The disadvantage with this style was that employees felt unvalued if after all the feedback was not incorporated in the decisions made. The style involved brainstorming sessions (Jackson & Jeffrey, 2010). Decisions taken into account were at the best interests of the employees as well as the business. Laissez Faire Management the manager rarely gave direction Cheong (2010), this was a good way to help develop individual contributors into leaders and makes teams stronger. It was a style that was best for strong, entrepreneurial subordinates in an organization with dynamic growth in multiple directions.

2.6.2 Capital Base

This is the capital structure of a company (shareholders' capital plus loans and retained earnings) used as way of assessing the company's worth.

SMEs have an all equity finance structure and have less debt finance to equity finance. Earnings, survival and growth of SMEs is strongly influenced by the capital structure hence government should design a home grown and SMEs friendly debt financing structure and managers of SMEs should seek professional advice when approaching financial institution for debt finance (Kahinde, 2012).

Capital structure decisions are vital decisions with great implications for the firm's financial performance. There is a positive relationship between debt ratio and financial performance of SMEs although not a statistically significant. As more and more funds are available, SMEs are able to generate more sources of capital to enable them to expand on their activities. As more opportunities will be exploited for better performance (Birundu, 2014).

2.7 A Review of Related Empirical Literature

Qasim & Ramiz (2014) "Impact of Liquidity and Solvency on Profitability on the Chemical Sector of Pakistan" indicated the fact that liquidity refers to the available cash for the near future, after taking into account the financial obligations corresponding to that period. Liquidity risk consist in the probability that the organization should not be able to make its payments to creditors, as a result of the changes in the proportion of long term credits and short term credits and the un correlation with the structure of organization's liabilities. Further, Qasim & Ramiz (2014) showed that liquidity management is very important for every organization that means to pay current obligations on business that

include operating and financial expenses that are short term. The researcher show that the liquidity ratio affects profitability positively thus recommends managers be capable of creating worth for their shareholders via reducing the digit of days accounts receivable and inventories to a rational minimum. This study only concentrated on profitability as a measure of performance on the chemical sector of Pakistan ignoring other factors.

Nyamao, Ojera, Otieno & Nyakundi (2013) "An Empirical Analysis of the Liquidity, Solvency and Financial health of SME's in Kisii Municipality", established that the current and the quick ratios of SMEs were not in a position to meet their maturity financial obligations as required. The study further concludes that the financial health of the SMEs is not good and this is manifested in their low profitability indices as measured by ROA, Gross profit Margin and Net profit margin. This study did not clearly state its objectives since the study only focused on analyzing the liquidity status, solvency status and the financial health of the SMEs in Kisii municipality. The independent and the dependent variable do not come out clearly in this study.

Muguchu (2010) in "Relationship between Access to Credit and Financial Performance of SMEs in Nairobi, Kenya", indicated that lack of access to credit is one of the main constraints and a number of factors have been identified to explain this problem. They include the segmented and incomplete nature of financial markets, which increases transaction costs associated with financial services. On the supply side, most formal financial institutions consider SMEs un-creditworthy, thus denying them credit. The study revealed that most borrowers borrowed only a small amount of money from the financial

institutions since they were only eligible to access such amounts given the criteria set by the institutions and also because they were reluctant to take out large amounts that they may not be able to repay. Such small amounts can only have so little impact on financial performance. The researcher concludes that all the independent variables that were tested in the study including loan value borrowed from financial institutions, amount of fixed asset, risk measured by standard deviation of ROA, age of the SME and size of the firm measured by turnover have a relationship with the financial performance of SMEs financial performance as measured by return on assets. This study looked at access to credit as a measure of performance. The results of this study alone cannot be generalized to other samples or population.

Study by Mwania (2011) on the effect of Biashara Boresha Loan (BBL) on Performance of Micro and Small enterprises owned by Kenya Commercial Bank (KCB) Ruiru branch customers with objectives to review the lending procedures of Biashara Boresha loan, to assess the effect of BBL on MSEs performance and to find out the challenges faced in lending to SMEs, found out that besides Biashara Boresha Loan (BBL), there are other factors believed to have an effect on business performance. It also found no conclusive results on the relationship between entrepreneurs' level of education and business performance. Of the 51% respondents who received training in their areas of business, 49.5% reported that their businesses were doing well, concluding that relevant training can produce positive results in the running of businesses. Mwania concluded that infant businesses need support in their early years when their motivation is high and innovation is low and that collateral requirements at KCB Ruiru should be made a bit flexible and repayment period should be increased to at least a year because SMEs only manage to

access a small amount of loan due to short repayment periods. 53% of BBL customers interviewed felt the process was cumbersome. Some felt that after availing all the required documentation, the turnaround time was not acceptable. 52% of the entrepreneurs utilized the loan advanced 100% for working capital and their revenue increased from previous thus boosting the business performance. 11.9% diverted the amounts advanced and they confessed as having difficulties in meeting their repayments on time.

They saw their sales turnover decrease from the previous due to the increase in operating costs brought about by the interest rates on the loans advanced. The study also found a positive correlation between BBL and entrepreneurs business performance and concluded that young businesses require more support financially to supplement their working capital. The study recommended that Kenya Commercial bank had a few issues to address such as lending procedures, collateral requirements and repayment period to ensure better customer satisfaction and that further research should be done on entrepreneur's competencies, competition, government regulation etc. This study did not consider other factors that can affect performance of SMEs apart from finance. The researcher only used one financial institution to come to a conclusion. This study too cannot be generalized to other population

A study by Mugo (2012) investigated factors affecting women entrepreneurs' performance in Central Business District (CBD) of the city of Nairobi, had the objectives, to assess the financial accessibility, assess the effect of record keeping challenges, to establish effect of budgeting on financial factors affecting women entrepreneurs' performance, and to

establish the effect of working capital management on the women entrepreneurs' performance. The study also identifies other factors affecting performance of women entrepreneurs as, lack of entrepreneurial training and education, outdated technology on women, poor access to markets, mismanagement of resources by women, lack of management skills and fraud. The study identifies finance as the major impediment affecting performance of women entrepreneurs. It recommends that banks should develop a product for women entrepreneurs that are special to allow them access loans. It further recommends that government should offer business training to women and that it should have good policies in support of women entrepreneurs. The study advocates for women education through seminars to help them keep proper records which shows proper business operation, and help them assess the business margins and mark-up to weigh the rate of business returns on their own. This study only considered performance of women entrepreneurs and left out the male entrepreneurs.

Kinyua (2014), researched on factors affecting the performance of small and medium enterprises in the Jua Kali Sector in Nakuru town, Kenya with objectives to investigate the role of finance, management skills, macro-environment factors and infrastructure on performance of small and medium-sized enterprises in the Jua Kali sector in Nakuru town. The findings indicated that; that access to finance had the potential to positively affect performance of SMEs; management skills were found to positively and significantly affect performance of SMEs; macro environment factors were found to significantly affect performance and Infrastructure did not significantly affect performance of SMEs in the study area. The study results also indicated that as number of years in operations increased

the performance in SMEs increased. The study recommended that banks should improve access to finance through offering better lending terms and conditions and collateral requirements; focus on acquiring appropriate management skills such as financial, marketing and entrepreneurial skills and effectively strengthen the macro environment in order to increase SMEs performance this study focused on the informal sector in Nakuru town specific to the area.

Kwanum (2012), in Nigeria found out that 84% of SMEs did not cover their business against risk. Another study by ICEAW by Virdi (2005) reported that about half of SMEs have no risk management procedures in place. Risk management is not totally embedded in SMEs and the ability to withstand this risk is less than that of large firms. Kagwathi, Kamau & Njau (2014) found out that many entrepreneurs lack a wide global view of business, low level of exposure, ignorance and inability to apply modern technology in their business. However the study by Kagwathi et al. (2014) carried out the study in an urban town, Nairobi, and used the results to come to conclusion that all SMEs in Kenya face a major challenge when it comes to risk diversification.

Nondi & Achoki (2006), in a survey of financial management problems in small hotels and restaurants in Kenya, found that 26 percent of these establishments reported lack of working capital as the most serious problem they face in their operations.

Atieno (2009) found that SMEs in Kenya that participate in business associations have better access to bank loans. In addition, membership to associations is important for SMEs as they facilitate access to financial services. Thus institutions, such as associations, which

support the SME‟s capacity to access financial services, become an important avenue for strengthening SMEs.

Namusonge, Mairura & Karanja (2013) in their survey on the role of financial intermediation in the growth of SMEs in Kenya, showed that the financial intermediaries played a significant role by offering banking services and extending credit facilities to SME businesses. Other support offered by financial intermediaries included; advisory services, training and financing the start of businesses. The existing evaluation procedures adopted by financial intermediaries were a big hindrance to credit access because they were stringent and bureaucratic was further revealed by the study. Finally they also found out that evaluation procedures made it difficult for businesses to access support from financial institutions because the procedures wasted a lot of business time and made financial intermediaries' services inaccessible to most businesses.

Osoro & Muturi (2013) concludes that accessibility to credit affects financial performance of small and medium enterprises positively. The easier it is to access credit, the higher the financial performance of the Small and medium enterprises. However, they also indicate that access to credit is not that easier from the financial institutions considering the many requirements one has to meet before the credit is approved to the entrepreneur for use in the business. There is evidence that as credit becomes more available, the financial performance of business becomes better and hence a chance for business growth (Osoro & Muturi, 2013)

CHAPTER THREE:
RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research design that was used in the thesis, target population, sampling procedure, area of study, research data collection instruments and procedures, how data was analyzed and ethical considerations. It explained why specific techniques and methods were used in design, analysis and data collection.

3.2 Research Design

The study used a descriptive survey (describing the characteristics of existing phenomenon) in soliciting information on financial intermediation in Kakamega Town. Descriptive survey method led to an intense accuracy at the phenomena of the moment and then helped the researcher to describe precisely what was being seen (Saunders, Lewis & Thornhill, 2007). A descriptive research design was concerned with describing characteristics of a problem. A survey research method (otherwise called communication approach) involves surveying people and recording their responses for analysis (Cooper & Schindler, 2003). It was used to generate quantitative data so as to come up with a detailed description of the state of financial intermediation and performance of SMEs as they exist in Kenya. The researcher therefore reported what had happened. The researcher was able to measure the variables presented in this study by the use of the observed data obtained during the field study.

The advantage of using descriptive survey design is that not only did it allow the researcher to measure the frequency of a phenomenon but also measured the preference of people

hence; enabling the researcher to discover the effect of financial intermediaries and performance of SMEs. Due to the short time period allocated towards data collection in the study, this method enabled the researcher to collect a large amount of data within a very small time frame.

3.3 Area of Research Study

The study was done in Kakamega Town, found in Kakamega County, Western Kenya. The Town has an area of 49.9Km^2 having thirteen administrative wards. The Town was chosen owing to its being cosmopolitan in various SACCOs. Kakamega Town, found within the heart of Kakamega County which was the second largest County in Kenya in terms of population after Nairobi County (KBS, 2013). The County also presented prominent SME's within western Kenya. The county is located in the western region of Kenya. (See appendix IV)

3.4 Target Population

According to Mugenda & Mugenda (2003) population is the entire group of individuals, events or objects having common observable characteristic while the target population referred to the population to which the researcher wanted to generalize the results to absolute population of a study. On the other hand Muijs (2004) looked at population as a group of people from which a sample was drawn for the purposes of a research. The target population used in this study involved all the SME's in Kakamega Town, Kenya. The SME's were grouped in different categories hence the study had the following respondents; 2336 from the general trade, wholesale and retail shop, 47 from the informal sector, transport and communication comprised of 162 SME's, agriculture and forestry 87 SME's,

366 accommodation and catering, from the professional and technical service the SME's were 812, 171 SME's from private education, health and entertainment service, last but not least industrial plants, workshop and contractors comprised of 168 SME's making a total of 4,149 SME's (Kakamega municipal council, 2014) as shown in Table 3.1 below.

Table 3.1 Target Population

S No	Category	Frequency
1	General trade, wholesale, retail stores, shops and personal services	2,336
2	Informal sector	47
3	Transport, storage and communication	162
4	Agriculture, forestry and water resources extraction	87
5	Accommodations and catering	366
6	Professional and technical services	812
7	Private education, Health and entertainment services	171
8	Industrial plants, factories, workshops and contractors	168
	Total Population	**4,149**

Source: Population of all registered SME's in Kakamega town

(*Municipal Council of Kakamega, 2014*)

3.5 Sampling Techniques

A sample technique; a procedure used to come up with a smaller group or subgroup from the accessible population (Mugenda & Mugenda, 2003). In order to obtain the optimum sample size; the researcher employed Kerlinger's method of determining sample size.

According to Kerlinger (1983), a sample was representative of the total population if it ranges between 10%-30% of the total population. The respective SME's was grouped in different classes depending on the industry they operate in.

The study employed a stratified random sampling technique to develop the sample component. Stratified sampling technique was generally applied in order to obtain a representative sample. The simple random sampling was used to select 415 SMEs from the strata, so that each and every one in the target population has an equal chance of inclusion from the target populations of 4149 SMEs. This was done so that the study does not miss any parameters that are vital to the research.

3.6 Sample Size

A sample refers to a representative sub-group of the population. For the purpose of this research the sample comprised of randomly selected SMEs from the groups stratified. Sample size refers to the number of items to be selected from the universe to constitute a sample as stated by (Kothari, 2004). The author further recommended that the sample size should neither be excessively large, nor too small.

Sub groups within the categories were used as stratified samples from which the sample size was determined on the basis of 10% recommended by Kombo & Tromp (2006).

10/100 x 4149 = 415 SMEs

3.7 Data collection instruments

Primary data was obtained from the questionnaires and interview schedules as research instruments. This helped collect the relevant depth of information needed.

3.7.1 Questionnaires for Lead Workers

Questionnaires were used to collect data from the lead workers it offered considerable advantage in administration; it presented an even stimulus potentiality to large numbers of people simultaneously and provided the investigation with an easy accumulation of data maintained that questionnaires gave respondents freedom to express their views or opinion and also made suggestion. In the process of developing the instruments, the researcher consulted the supervisors who were expert in this field. They assisted in verifying whether the instruments were appropriate for obtaining the needed information. In order to achieve the research objectives the questionnaire was designed to elicit accurate and relevant response from the respondents based on each of the research question and constructs on the conceptual frame work. They are confidential, save on time, no bias cover wide area (Mugenda, & Mugenda, 2003). The questionnaire as an instrument used both closed ended and open ended questions in its structure. The questions were developed in line with the study specific objectives and were divided into five sections. Section A consisted of general questions about the respondent, Section B consisted of various questions on roles of financial intermediaries, and Section C consisted of questions addressing organizational factors which influence the adaptation of the roles of financial intermediaries hence affecting the performance of SME's. The questionnaire was designed based on five Point Likert-type scales. The questions were constructed to generate data to help achieve the objectives of the study. Closed-ended questions on the other hand were used to save time and to motivate the respondents to answer. The researcher adopted drop and pick technique in administering questionnaires to respondents. Interviews were conducted to managers, acting managers and the lead workers. Their views were useful in collaborating the respondents' opinions from the questionnaires. (See appendix II and III)

3.7.2 Interview Guide for Managers

Interview guide was used to collect in depth information from the managers and the acting managers. Interview schedules were used as instruments because they enabled the researcher to obtain very detailed information and also enabled the researcher to control the respondents in the right direction. They also make it possible to obtain data required to meet specific objectives of the study hence increasing precision.

3.8 Validity of the Research Instruments

Validity defines the degree to which result obtained from the analysis of the data actually represented the phenomenon under study (Mugenda & Mugenda, 2003). Validity refers to the accuracy of a measuring instrument in measuring the variable that it is intended to measure. According to Orodho (2004), validity can be defined as the extent to which a measuring instrument provided adequate coverage of the topic under study or in simple terms, the degree of relevance the instruments were towards the research. To determine the validity of the instruments, the instruments was developed and presented over to the research experts and the supervisors in the Department of Business Management of Masinde Muliro University of Science and Technology to establish whether the instruments measured what they intended to measure and modify them accordingly. These questionnaires were tested by piloting them. This helped reveal vague questions, take suggestions made by respondents and detect deficiencies which need to be addressed (Mugenda & Mugenda 1999). Thereafter necessary modifications were undertaken. Pretesting was to ensure that the questions were able to generate the required results in terms of construct and content validity. On the other hand, to ensure face and construct validity, the questionnaire was guided by the researcher's conceptual framework in order to test and measure the key elements of financial intermediaries on the performance of

SMES. Further literature review was undertaken to establish the validity of the research instruments. They were scrutinized in depth so as to establish content validity. The verification process was done by experts.

3.9 Reliability of Research Instruments

Golafshani (2003) stated that the extent, to which results were consistent over time and an accurate representation of the total population under study, referred to as reliability and if the results of a study were reproduced under similar methodology, then the research instrument was considered to be reliable. The reliability of a study had to do with the degree to which the measuring instruments used in the study yielded consistent results or data after repeated trials (Mugenda & Mugenda, 2003).

A test-retest technique was used to measure reliability of the data. According to Mugenda & Mugenda (2003), it involved administering the same instrument twice to the same group or subject and after keeping the initial conditions constant, administered the same test to the same subject after few weeks and then correlated the scores to obtain correlation coefficient. The correlation coefficient was high hence the instrument was said to yield data that have test–retest reliability. The data gathered from the pilot study was then subjected to Cronbach's alpha a coefficient of reliability that gave a non-biased estimate of data (Zinbarg, Revelle & Yovel, 2005). Both reliability and validity was high hence desirable (Golafshani, 2003).

The information from the piloted questionnaire was tested using the Cronbach's alpha co-efficient which should be 0.7 and above. The test is done as follows;

Suppose that we measure a quantity which is a sum of K components (*K-items* or *testlets*): $K=Y_1+Y_2+\ldots Y_k$.

The Cronbach's α can be defined as

$$\alpha = \frac{K\bar{c}}{(\bar{v} + (K-1)\bar{c})}$$

Where;

$\bar{v}$ = the average variance of each component (item), and

$\bar{c}$ = the average of all covariance between the components across the current sample of persons (that is, without including the variances of each component).

The *standardized Cronbach's alpha* can be found by;

$$\alpha_{\text{standardized}} = \frac{K\bar{r}}{(1 + (K-1)\bar{r})}$$

Where K is as above and $\bar{r}$ the mean of the non-redundant correlation coefficients (i.e., the mean of an upper triangular, or lower triangular, correlation matrix).

Ritter (2010) says higher values of alpha are more desirable. Some professionals, as a rule of thumb require a reliability of 0.70 or higher (obtained on a substantial sample) before they will use an instrument. The acceptance is 0.9 and above for excellent consistency, 0.7 to 0.8 good, 0.7 to 0.8 as acceptable. 0.6 to 0.7 shows questionable consistency, 0.5 to 0.6 as poor, and below 0.5 will be unacceptable consistency.

Table 3.2: Reliability test

Reliability statistics	
N of items	Cronbach's alpha
30	0.826

Source: Research data 2014

3.10 Data collection Procedure

The study relied heavily on primary and secondary data. Primary data was collected through the administration of an in-depth questionnaire, the questionnaire was designed based on five point likert-type scales and it consisted of both open ended and closed ended questions. The researcher introduced the objective of the research to the SMEs include in the sample. Questionnaires were then circulated to the various employees who were then asked to answer the questions on their own and return the duly completed questionnaires to the researcher within a week. The questions were constructed to generate data to help achieve the objectives of the study. Open-ended questions were used so that the respondents could get a chance to express themselves freely. Closed-ended questions on the other hand were used to save time and to motivate the respondents to answer. The questionnaires were administered personally through a 'drop and pick' technique while secondary data was collected from existing literature from the books, journals, financial institution, the internet, Economic Surveys, financial Journals, in-house newsletters and other reliable sources.

3.11 Measurement of variables

Measurement is the process of mapping aspects of a domain onto other aspects of a range to some rule of correspondence (Kothari, 2010). In research measurement involves

devising some form of scale in the range and then mapping the properties of the objects to be measured onto the scale.

3.12 Operational Definition of Variables

This section looks at the operational definition of variables as shown in Table 3.3 below.

Table 3.3: Operational definition of terms

Research objectives	Independent variable	Dependent variable	Statistical tool
To determine the effect of liquidity on the performance of SME's	Liquidity	Performance of SMEs	Descriptive statistics and Pearson correlation Coefficient
To determine the effect of risk diversification on the performance of SME's	Risk diversification	Performance of SMEs	Descriptive statistics and Pearson correlation Coefficient
To determine the effect of pool saving on the performance SME's.	Pool savings	Performance of SMEs	Descriptive statistics and Pearson correlation Coefficient

Source: Research data 2014

3.13 Data Analysis

Quantitative data collected from respondents was coded and analyzed using Statistical Package for Social Sciences (SPSS version 20). Both descriptive and inferential statistics was used in the study. Descriptive statistics (Sekaran, 2003) referred to statistics that describe the phenomena of interest. These phenomena included; frequencies, mean and extent of variability in the set. On the other hand, inferential statistics gave information on

how the variables related to each other. Thus interpretation of data was done by drawing inferences from the computed frequencies, means and percentages. Inferential statistics involved Pearson's coefficient of correlation, which was used to establish the relationship among the variables. Simple regressions analysis was used to check on the relationship between role of financial intermediaries (independent variable) and performance of SME's (dependent variable). The relationship between role of financial intermediaries and the performance of SME's followed a regression model of the nature $P=\alpha+\beta_1 FI+e$ while the relationship between contextual factors and solvency of listed firms is expected to follow a regression model of the nature $P=\alpha+\beta_2 OF+e$; where, P=Performance, α=intercept term, $\beta_1$and β_2=Beta coefficients, FI=Financial intermediation OF=Organizational factors, and e= constant term. The following table shows how the tests and modeling was done.

Table 3.4: Hypothesis Testing and Regression Model

Hypothesis	Hypothesis Test	Regression Model
$H0_1$: Liquidity has no effect on the performance of SME's (P) in Kakamega Town.	Karl Pearson's zero order coefficient of correlation (Beta test)	Reject $H0_1$ if $\beta_1 \neq O$ $P=\alpha+\beta_{1L}+e$
$H0_2$: Risk diversification has no effect on the performance of SME's(P) in Kakamega Town.	Karl Pearson's zero order coefficient of correlation (Beta test)	Reject $H0_2$ if $\beta_2 \neq 0$ $P=\alpha+\beta_{2RD}+e$
$H0_3$: Pool saving has no effect on the performance of SME's (P) in Kakamega Town.	Karl Pearson's zero order coefficient of correlation (Beta test)	Reject H03 if $\beta 3 \neq O$ $P=\alpha+\beta 3ps+e$
$H0_4$: Organizational factors have no moderating effect on the relationship between role of financial intermediaries and performance of SME's in Kakamega town.	First order partial correlation coefficient (rxy.z)	Reject $H0_4$ if $rxy._{z1} \neq r_{xyz2} \ldots \neq$ $rxy.zn \neq rxy.$ $P=\alpha+\beta_{4OF}+e$

Source: Researcher 2014

It is worth noting that the hypotheses were tested at 0.05% significance level, with 95% confidence, which is acceptable in non –clinical research works (SPSS version 20).

3.14 Ethical Considerations

This ethical consideration was necessary to maintain the integrity of the study as well as the integrity of the researcher (Creswell, 2002). Ethical considerations protected the rights of participants by ensuring confidentiality. This ethical consideration was necessary to

maintain the integrity of the study as well as the integrity of the researcher (Saunders et al., 2007). It is unethical for the researcher to share identifying information regarding the study with any one not associated with this study. The respondents were assured of the confidentiality of information given and were informed that their views were used for the purpose of research only.

All information used to fulfill the research objectives of this research was gained from publicly accessible sources or directly from the SMEs being researched .Furthermore, the researcher acquired relevant research permit authorizing him to carry out research in the field of study.

CHAPTER FOUR:
FINDINGS AND DISCUSSION

4.1 Introduction

The results of data analysis are presented in this chapter. This chapter presents data analysis. The chapter has been divided into the following sections: demographic results, descriptive analysis, inferential analysis, hypotheses testing and discussions of results.

4.2 Return rate of questionnaires

The questionnaire return rate was 96.4% since 400 questionnaires were returned out of 415 that were supplied. The response rate of at least 90% was considered a good rate according to (Saunders et al., 2007).

4.3 General Information of the Respondents

It was important to have general background information concerning the responses. This information was important to establish whether they were in a better position to respond to the questionnaires or not. The information sought for purposes of having background information included, gender, age bracket of the respondents, level of education and the number of years they have worked as SME's. The following were response recorded.

4.3.1 Gender

In question 1 of the questionnaire, the respondents indicated their gender and the results were recorded in Table 4.1 below.

Table 4.1: Gender Distribution

	Frequency	Percentage
Male	267	66.8
Female	133	33.2
Total	**400**	**100.0**

Source: Research Data, 2014

According to the results in Table 4.1 above, majority of the respondents were males (66.8%) while the rest were females (33.3%). It was an indication that more male participated in this study than females. This could be as a result of more male employees than female. Alternatively, women's traditional reproductive roles have to be combined with other activities, like employment leaving little energy and time for the latter (UDEC, 2002), may explain why the number of women who participated in this study is lower. However, the representation of women is enough in the study.

4.3.2 Age Bracket of Respondents

The second question on the background information was to establish the age bracket of the respondents. The results in table 4.2 show that, between 20 and 30 years old, there were 10.8% of the respondents; between 31 years and 40 years, there were 38%; between 41 years and 50 years, there were 45%; while those who were 51 years old and above were 6.3%. From these results, it implies that majority of the respondents (83%) were in the active age bracket of 31-50 years.

Table 4.2: Age Distribution of Respondents

Age Bracket	Frequency	Percentage
20-30 Years	43	10.8
31-40 years	152	38.0
41-50 Years	180	45.0
Over 50 Years	25	6.2
	400	**100.0**

Source: Research Data, 2014

Age affects the level of motivation to perform any function in an organization. Majority of respondents were in the age range of between 31 to 50 years old. This age is important in a business setting for instance in the SME's because it is an active age that is quite productive.

4.3.3 Educational Level of the Respondents

The level of education was very important in this study. The respondents were to respond to the questions on the questionnaire provided. This information was vital in making decisions on the role of financial intermediaries on the performance of SME's in Kakamega Town. The results were recorded in Table 4.3 below. The results illustrate that 1% of the respondents had primary education, 22% had secondary education, 20.8% had college education, 13.5% had university education, and 15.8% had post graduate education, while the remaining 27% had professional qualification. From the results, over 95% of the respondents have enough education background to fill and respond to the questionnaires with ease.

Table 4.3: Educational level of Respondents

Level of Education	Frequency	Percent
Primary	4	1.0
Secondary	88	22.0
College	83	20.75
University	54	13.5
Postgraduate	63	15.75
Professional qualification	108	27.0
Total	**400**	**100.0**

Source: Research Data, 2014

4.3.4 Number of Years Worked as an SME

This section was also important to the study. It helped establish the years of experience they have in their business. The results were as shown in Table 4.4 below

Table 4.4: Number of Years Worked

Number of Years Worked	Frequency	Percent
Less than 5	67	16.75
5-10 years	187	46.75
Over 10 years	146	36.5
Total	**400**	**100.0**

Source: Research Data 2014

From the results, 16.75% of the respondents have worked for less than 5 years, 46.75% have worked between 5 to 10 years while the remaining 36.5% have worked for over ten

years. The results indicate that majority of the respondents i.e. 83.25% have worked for at least 5years. This implies that they are in good position to have important information to the study regarding the performance of their businesses.

4.4 Descriptive Statistics of Financial Intermediaries

Role of financial intermediaries was the independent variable on the conceptual framework shown in Figure 1.1. The constructs under role of financial intermediaries were; liquidity, risk diversification and pool saving. These variables were analyzed through dimension reduction of factor analysis (i.e. through central limit concept of varimax) and their mean were then computed and further used in the study. The following results demonstrate the outcome of the study.

4.4.1 Descriptive Statistics of Liquidity on the Performance of SME's

There were several questions that aimed at establishing from the respondents how liquidity affected the performance of SME's. The respondents were asked to score the questions that were rated on the five (5) point Likert Scale ranging from 1= Strongly Disagree, 2 = Disagree, 3 = Neither Agree nor Disagree, 4 = Agree, and 5 = Strongly Agree. The results were as shown in Table 4.5 below. From the results the question; SME's maintain active accounts with their banks and other financial institutions like Saccos which improves the performance of SME's had a mean of 4.7525 with standard deviation of 0.53099, SME's receive loans from the financial institutions like banks among others which improves their performance had a mean of 4.5625 with standard deviation of 0.63805, SME's receive varieties of credit facilities from banks to improve on their capital base had a mean of 4.5500 with standard deviation of 0.65847, The SME's repay their credit facilities on time and still manage to run their businesses had a mean of 4.5750 with standard deviation of

0.6167.

The mean scores are above 4 and their respective standard deviations are less than 1. From these results in Table 4.5 below, the overall mean of liquidity on performance of SME are all above 4, significantly showing that there is agreement of the respondents to the fact that liquidity has an effect on the business performance of SMEs in Kenya. An overall standard deviation of less than 1 for the effect of liquidity on SMEs performance further confirms that indeed the means represent the general level or true measure of agreement. This concurs with Nyamao, Ojera, Otieno & Nyakundi (2013) "An Empirical Analysis of the Liquidity, Solvency and Financial health of SME's in Kisii Municipality", established that the current and the quick ratios of SMEs were not in a position to meet their maturity financial obligations as required. The study further concludes that the financial health of the SMEs is not good and this is manifested in their low profitability indices as measured by ROA, Gross profit Margin and Net profit margin.

Table 4.5: Descriptive Statistics of Liquidity

	Descriptive Statistics of Liquidity on Performance	Mean	Standard Deviation
i.	SME's maintain active accounts with their banks and other financial institutions like Saccos which improves the performance of SME's	4.7525	0.53099
ii.	SME's receive loans from the financial institutions like banks among others which improves their performance	4.5625	0.63805
iii.	SME's receive varieties of credit facilities from banks to improve on their capital base	4.5500	0.65847
iv.	The SME's repay their credit facilities on time and still manage to run their businesses	4.5750	0.61671

Source: Research Data 2014

4.4.2 Descriptive Statistics of Risk Diversification on Performance of SME's

There were several questions that aimed at establishing from the respondents how risk diversification affected the performance of SME's. The respondents were asked to score the questions that were rated on the five (5) point Likert scale ranging from ranging from 1= Strongly Disagree, 2 = Disagree, 3 = Neither Agree nor Disagree, 4 = Agree, and 5 = Strongly Agree. The results were as shown in Table 4.6 below. From the results the items. Resources, risk management skills and weak structural features make SMEs vulnerable to harmful effects of risk had a mean 4.5400 and a standard deviation of 0.68525; Amount of

capital determined the number of investments to make had a mean of 4.5300 and a standard deviation of 0.69664; SME's are guided by financial institutions on how to make investment which positively affects performance had a mean of 4.4950 and a standard deviation of 0.699973; Financial institution advice SMEs of the type of investments to undertake had a mean of 4.5411 and a standard deviation of 0.75591.

The mean scores are above 4 and their respective standard deviations are less than 1. From these results in Table 4.6 below, the overall mean of risk diversification on performance of SME are all above 4, significantly showing that there is agreement of the respondents to the fact that liquidity has an effect on the business performance of SMEs in Kenya. An overall standard deviation of less than 1 for the effect of risk diversification on SMEs performance further confirms that indeed the means represent the general level or true measure of agreement. The statistics were in agreement with Kwanum (2012), in Nigeria found out that 84% of SMEs did not cover their business against risk. Another study by ICEAW by Virdi (2005) reported that about half of SMEs have no risk management procedures in place. Risk management is not totally embedded in SMEs and the ability to withstand this risk is less than that of large firms.

Kagwathi et al (2014) found out that many entrepreneurs lack a wide global view of business, low level of exposure, ignorance and inability to apply modern technology in their business.

Table 4.6: Descriptive Statistics of Risk Diversification

	Descriptive Statistics of Risk Diversification	Mean	Standard Deviation
i.	Resources, risk management skills and weak structural features make SMEs vulnerable to harmful effects of risk	4.5400	0.68525
ii.	Amount of capital determined the number of investments to make	4.5300	0.69664
iii.	SME's are guided by financial institutions on how to make investment which positively affects performance	4.4950	0.69973
iv.	Financial institution advice SMEs of the type of investments to undertake	4.5411	0.75591

Source: Research Data 2014

4.4.3 Descriptive Statistics of Pool Saving on Performance of SME's

There were several questions that aimed at establishing from the respondents how pool saving affected the performance of SME's. The respondents were asked to score the questions that were rated on the five (5) point L4.4.ikert scale ranging from ranging from 1= Strongly Disagree, 2 = Disagree, 3 = Neither Agree nor Disagree, 4 = Agree, and 5 = Strongly Agree. The results were as shown in Table 4.7 below. From the results, the question; financial institutions enables SME's to have a platform where they can save regularly had a mean of 4.3800 with standard deviation of 0.93423, SME's are not worried

of their savings getting lost because the banks provide them the surety had a mean of 4.4025 with standard deviation of 0.88456, SME's are advised on the importance of pool savings to their business performance had a mean of 4.4675 with standard deviation of 0.79720, Pool saving has a positive effect on the performance of SME's had a mean of 4.5525 with standard deviation of 0.67333.

The mean scores are above 4 and their respective standard deviations are less than 1. From these results in Table 4.7 below, the overall mean of pool savings on performance of SME are all above 4, significantly showing that there is agreement of the respondents to the fact that liquidity has an effect on the business performance of SMEs in Kenya. An overall standard deviation of less than 1 for the effect of pool savings on SMEs performance further confirms that indeed the means represent the general level or true measure of agreement. This is in agreement with Buckle & Thompson (2004, p. 37). Apart from mobilizing capital resources, financial intermediaries increased returns to the savers through reduction of transaction costs. Although interests charged on savings was elastic due to the market conditions, intermediaries increased the returns of their clients through adoption of the latest technology, which facilitated lower negotiation as well as searched the benefits of the savers and the financial intermediary.

Depositors were also able to receive interest on their savings and checking accounts, and they also had the freedom to change the finances into goods or services at any time they feel it is essential to do so (Buckle and Thompson 2004, p.37)

Table 4.7: Descriptive Statistics of Pool Saving on Performance of SME's

	Descriptive Statistics of Pool Saving on Performance	Mean	Standard Deviation
i.	Financial institutions enables SME's to have a platform where they can save regularly	4.3800	0.93423
ii.	SME's are not worried of their savings getting lost because the banks provide them the surety	4.4025	0.88456
iii.	SME's are advised on the importance of pool savings to their business performance	4.44675	0.79720
iv.	Pool saving has a positive effect on the performance of SME's	4.5525	0.67333

Source: Research Data 2014

4.5 Descriptive Statistics of Organizational Factors

The organizational factors that were used in the study were management style and capital base. Descriptive statistics was also done on them to establish how they moderately affected performance of SME's. The respondents were asked to score the questions that were rated the five (5) point Likert scale ranging from ranging from 1= Strongly Disagree, 2 = Disagree, 3 = Neither Agree nor Disagree, 4 = Agree, and 5 = Strongly Agree. The results were as follows:

4.5.1 Descriptive Statistics of How Management Style Moderates the Relationship between the Role of Financial Intermediaries and Performance of SME's

Several questions regarding management style and how it moderated the relationship between the role of financial intermediaries and performance of SME's were asked.

Table 4.8: Descriptive Statistics of Management Style

	Descriptive Statistics of Management Style	Mean	Standard Deviation
i.	Good management style increases customer loyalty	4.6012	0.62528
ii.	SME's are managed by people who have the required skills in management which improves the performance of businesses	4.5621	0.65763
iii.	SME's with better managers performs better than those without	4.5809	0.67434
iv.	The performance of a business is greatly affected by how it is managed	4.5325	0.70369

Source: Research Data 2014

From the results in Table 4.8, the questions scored differently as follows; SME's are managed by people who have the required skills in management which improves the performance of businesses had a mean of 4.5621 and standard deviation of 0.65763, Good management style increases customer loyalty had a mean of 4.6012 and standard deviation of 0.62528, most of the SME's receive formal training in the relevant areas of business had a mean of 4.5809 and standard deviation of 0.67434, SME's with better managers performs better than those without had a mean of 4.5325 with standard deviation of 0.70369. The last question the performance of a business is greatly affected by how it is managed had a mean of 4.3950 with standard deviation of 0.88936.

The mean scores are above 4 and their respective standard deviations are less than 1. From these results in Table 4.8 above, the overall mean of management style on performance of SME are all above 4, significantly showing that there is agreement of the respondents to the fact that liquidity has an effect on the business performance of SMEs in Kenya. An overall standard deviation of less than 1 further confirms that indeed the means represent the general level or true measure of agreement. It concurs with Kinyua (2014) who found out that management skills positively and significantly affected performance of SMEs.

4.5.2 Descriptive Statistics of How Capital Base Moderates the Relationship between the Role of Financial Intermediaries and Performance of SME's

Several questions regarding capital base and how it moderated the relationship between financial intermediation and performance of SME's were asked. The results were as shown in Table 4.9 below:

Table 4.9: Descriptive Statistics of Capital Base

	Descriptive Statistics of Capital Base	Mean	Standard Deviation
i.	An SME without enough capital to run the business cannot operate well and hence performance is affected	4.4800	0.80699
ii.	The higher the capital base of SMEs the higher their performance	4.3825	0.91009
iii.	Generally business with low capital base performs poorly compared to those with high capital base	4.3675	0.92444
iv.	Availability of capital has a great influence on the performance of SMEs	4.3825	0.93186
v.	Capital base affects performance of SMEs positively	4.3425	0.94733

Source: Research Data 2014

From the results in Table 4.9, the questions scored differently as follows; The higher the capital base of SME's the higher their performance had a mean of 4.3825 and standard deviation of 0.91009; an SME without enough capital to run the business cannot operate well and hence performance is affected had a mean of 4.4800 and standard deviation of 0.80699; Availability of capital has a great influence on the performance of SME's had a mean of 4.3825 and standard deviation of 0.93186; Capital base affects performance of SME's positively had a mean of 4.3425 with standard deviation of 0.94733. The last

question generally businesses with low capital base performs poorly is compared to those with high capital base had a mean of 4.3675 with standard deviation of 0.94444.

The mean scores are above 4 and their respective standard deviations are less than 1. From these results in Table 4.9 above, the overall mean are all above 4, significantly showing that there is agreement of the respondents to the fact that liquidity has an effect on the business performance of SMEs in Kenya. An overall standard deviation of less than 1 further confirms that indeed the means represent the general level or true measure of agreement.. This concurs with Birundu (2014), with Capital structure decision are vital decisions with great implications for the firm's financial performance. There is a positive relationship between debt ratio and financial performance of SMEs although not a statistically significant. As more and more funds are available, SMEs are able to generate more sources of capital to enable them to expand on their activities. As more opportunities will be exploited for better performance.

4.6 Inferential Statistics of the Role of Financial Intermediaries

Inferential statistics helped the research study to establish the relationship between the variables under study. The study sought to establish the Pearson correlation coefficient among the various dimensions that built up the independent variable. The various factors were grouped together through dimension of reduction of varimax. The factors were then grouped as 1,2,3, where they represent liquidity, risk diversification and pool savings. The table 4.10 below shows the correlation results of the variables.

Table 4.10: Correlations of Role of Financial Intermediaries

		1	2	3
Liquidity	Pearson Correlation	1	0.723**	0.613**
	Sig. (2-tailed)		0.000	0.000
	N	400	400	400
Risk Diversification	Pearson Correlation	0.723**	1	0.735**
	Sig. (2-tailed)	0.000		0.000
	N	400	400	400
Pool Saving	Pearson Correlation	0.613**	0.735**	1
	Sig. (2-tailed)	0.000	0.000	
	N	400	400	400

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

Source: Research Data 2014

From the results in Table 4.10, it shows that liquidity had a statistically significant positive correlation ($r=0.723$ and $p\leq0.01$) with risk diversification. Liquidity had a statistically significant positive correlation ($r=0.613$ and $p\leq0.01$) with pool saving. Risk diversification had a statistically significant positive correlation ($r=0.735$ and $p\leq0.01$) with pool savings. On the overall, there is statistically significant positive correlation among the various roles played by financial intermediaries. The results indicate that when one role was positively affecting performance of SME's, the other two were also affecting performance.

4.7 Inferential Statistics of Moderating Organizational Factors

The organizational factors which were moderating variable in the study included the management style and capital base. The two variables were correlated and the results presented in Table 4.11 below. The results indicate a statistically significant positive correlation between management style and capital base ($r=0.784$, $pv\leq0.01$. This implies there exists statistically significant positive correlation among all the organizational factors. This implies that as one factor was having a positive moderating effect on the relationship between the independent and dependent variable, other factor too was having a positive moderating effect at the same time.

Table 4.11: Correlation of Organizational Factors

		Management Style	Capital Base
Management	Sig. (2-tailed)	0.000	0.000
Style	N	400	400
	Pearson Correlation	1	0.784**
Capital Base	Sig. (2-tailed)	0.000	0.000
	N	400	400
	Pearson Correlation	0.784**	1

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

Source: Research Data 2014

4.8 Hypothesis Testing and Discussion

The central thesis of this research was to establish the role of financial intermediaries on the performance of SME's in Kakamega Town. The specific objective of the study were;

to determine the effect of liquidity on the performance of SME's, to determine the effect of risk diversification on the performance of SME's, to determine the effect of pool saving on the performance of SME's and to determine the moderating effect of organizational factors on the relationship between role financial intermediaries and performance of SME's in Kakamega Town. The objectives were further stated into null hypotheses.

The null hypotheses were as follows; liquidity has no effect on the performance of SME's, risk diversification has no effect on the performance of SME's, pool savings has no effect on the performance SME's and organizational factors have no moderating effect on the relationship between role of financial intermediaries and performance of SME's in Kakamega Town. The study employed zero order and first order partial correlation to establish the effect of the variables. These hypotheses were tested at 0.05% significance level, with 95% level of confidence, which is acceptable in non–clinical research works. The analysis was done as follows;

4.8.1 Effect of Liquidity on the Performance of SME's in Kakamega Town

In order to determine whether liquidity had any effect on the performance of SME's in Kakamega Town, the study set out the following hypothesis;

- $H_0 1$: Liquidity has no effect on the performance of SME's in Kakamega Town

The study used the correlation (beta, β) to test this hypothesis. The test criteria is set such the study rejects the null hypothesis $H_0 1$ if $\beta_1 \neq 0$. To test the hypothesis, a mean of business performance (P) was correlated with mean of liquidity (L)

Table 4.12: Regression Results of Liquidity against Performance

Model Summary						
Model		***R***	***R Square***	***Adjusted R Square***	***Std Error of the Estimate***	
1	Predictors: (Constant), Liquidity	0.753[a]	0.567	0.566	0.46958	
		Sum of Squares	***DF***	***Mean Square***	***F***	***Sig.***
	Regression	114.949	1	114.949	521.296	0.000[b]
	Residual	87.761	398	0.221		
	Total	**202.710**	**399**			
		Unstandardized Coeficients		***Standardized Coeficients***	***T***	***Sig.***
		B	Std. Error	Beta		
	(Constant)	2.030	0.116		17.56	0.000
	Liquidity	0.590	0.026	0.753	22.83	0.000

a. Dependent Variable: SME performance

b. Predictors: (Constant) Liquidity

Source: Research Data 2014

This correlation results in Table 4.12 above show that liquidity has a positive effect on the performance of SME's. The results indicate that 56.7% of the SME's performance can be explained by liquidity (r^2=0.567) and the relationship followed a simple regression model of the nature $P=\alpha+\beta_1 L+e$, where P is the SME performance, α was the constant intercept of which in our case was 2.030 and beta β_1=0.753, L is liquidity and e is the standard error

term.

The correlation results between the mean of liquidity and the mean of SME's performance (P) had a beta term $\beta_1=0.753$ at p=0.05. In the hypothesis criteria, we were to reject $H_0 1$ if $\beta_1 \neq 0$. However, from these results, the value of beta $\beta_1=0.753$ and yet $0.753 \neq 0$. The study therefore rejects the null hypothesis and conclude that liquidity has a statistically significant positive effect on the performance of SME's in Kakamega Town.

4.8.2 Effect of Risk Diversification on the Performance of SME's in Kakamega Town

In order to determine whether risk diversification had any effect on the performance of SME's in Kakamega Town, the study set out the following hypothesis;

- $H_0 2$: Risk diversification has no effect on the performance of SME's in Kakamega Town.

The study used the correlation r (beta, β) to test this hypothesis. The test criterion is set such the study rejects the null hypothesis $H_0 2$ if $\beta_2 \neq 0$. To test the hypothesis, mean of business performance (P) was correlated with mean of risk diversification (RD).

Table 4.13 Regression Results of Risk Diversification (RD) against Performance

Model Summary						
Model		***R***	***R Square***	***Adjusted R Square***	***Std Error of the Estimate***	
1	Predictors: (Constant), Risk Diversification	0.697[a]	0.486	0.485	0.51702	
		Sum of Squares	***DF***	***Mean Square***	***F***	***Sig.***
	Regression	100.548	1	100.548	376.144	0.000[b]
	Residual	106.390	398	0.267		
	Total	**206.938**	**399**			
		Unstandardized Coeficients		***Standardized Coeficients***	***T***	***Sig.***
		B	Std. Error	Beta		
	(Constant) Risk	2.195	0.127		17.24	0.000
	Diversion	0.552	0.028	0.697	19.39	0.000

a. Dependent Variable: SME performance; b. Predictors: (Constant) Risk Diversion

Source: Research Data 2014

This correlation results in Table 4.13 above show that risk diversification has a positive effect on the performance of SME's. The results indicate that 48.6% of the SME's performance can be explained by risk diversification (r^2=0.486) and the relationship followed a simple regression model of the nature $P=\alpha+\beta_2 RD+e$ where P is the SME performance, α was the constant intercept of which in our case was 2.195 and beta β_2 = 0.697, RD was risk diversification and e was the standard error term.

The correlation results between the mean of risk diversification and the mean of SME's performance (P) had a beta term $\beta_2=0.697$ at $p=0.05$. In the hypothesis criteria, we were to reject $H_0 2$ if $\beta_2 \neq 0$. However, from this results, the value of beta $\beta_2=0.697$ and yet $0.697 \neq 0$. The study therefore rejects the null hypothesis and concludes that risk diversification has a statistically significant positive effect on the performance of SME's in Kakamega Town.

4.8.3 Effect of Pool Saving on the Performance SME's in Kakamega Town

In order to determine whether pool saving had any effect on the performance of SME's in Kakamega Town, the study set out the following hypothesis;

- $H_0 3$: Pool savings has no effect on the performance SME's in Kakamega Town

The study used the correlation r (beta, β) to test this hypothesis. The test criteria is set such the study rejects the null hypothesis $H_0 3$ if $\beta 3 \neq 0$. To test the hypothesis, the mean of business performance (P) was correlated with mean of pool saving (ps). The correlation results between the mean of pool saving and the mean of SME's performance (P) had a beta term $\beta 3=0.731$ at $p=0.05$.

Table 4.14: Regression Results of Pool Saving (PS) against Performance

Model Summary					
Model		***R***	***R Square***	***Adjusted R Square***	***Std Error of the Estimate***
1	Predictors: (Constant), Pool Saving	0.731[a]	0.534	0.533	0.50893

	Sum of Squares	***DF***	***Mean Square***	***F***	***Sig.***
Regression	118.024	1	118.024	455.673	0.000[b]
Residual	103.086	398	0.259		
Total	**221.110**	**399**			

	Unstandardized Coeficients		***Standardized Coeficients***	***t***	***Sig.***
	B	Std. Error	Beta		
(Constant)	1.966	0.125		15.69	0.000
Risk Diversion	0.598	0.028	0.731	21.34	0.000

a. Dependent Variable: SME performance; b. Predictors: (Constant) Risk Diversion

Source: Research Data 2014

In the hypothesis criteria, we were to reject $H_0 3$ if $\beta 3 \neq 0$. However, from this results, the value of beta $\beta 3 = 0.731$ and yet $0.731 \neq 0$. The study therefore rejects the null hypothesis and conclude that pool saving has a statistically significant positive effect on the performance of SME's in Kakamega Town.

This correlation results in Table 4.14 below show that pool saving had a positive effect on

the performance of SME's. The results indicate that 53.4% of the SME's performance can be explained by pool saving (r^2=0.534) and the relationship followed a simple regression model of the nature P=α+β3ps+e where P is the SME performance, α was the constant intercept of which in our case was 1.966 and beta β3=0.731, ps is pool saving and e is the standard error term.

4.8.4 Moderating Effect of Organizational Factors on the Relationship between Role of Financial Intermediaries and Performance of SME's in Kakamega Town

The study established the moderating effect of organizational factors using first order partial correlation. Afterwards, the partial correlation coefficients were then compared with the simple coefficients generated from the direct zero order partial correlation of role of financial intermediaries and performance of SME's (r=0.764) in order to determine the magnitude and direction of the moderating effect of the organizational factors. To get this end, the following null hypothesis was constructed to carry out the test.

- $H_0$4: Organizational factors have no moderating effect on the relationship between role of financial intermediaries and performance of SME's in Kakamega Town.

We reject $H_0$4 if $r_{xy.z1} \neq r_{xyz2} \neq rxy.zn \neq r_{xy.,}$given P=α+$\beta_4$OF+e

Table 4.15: Results of Zero Order Partial Correlation

Model Summary					
Model		***R***	***R Square***	***Adjusted R Square***	***Std Error of the Estimate***
1	Predictors: (Constant), Aggregate Mean of role of financial intermediaries	0.764[a]	0.583	0.582	0.58428

Source: Research Data 2014

The zero order partial correlation results are then compared to the first order partial correlation results shown in Table 4.16 below.

Table 4.16: Correlation Results When SME's Performance is Held Constant

Moderator (Control variable)	**First order partial correlation coefficient $r_{xy.z}$**	**Effect of organizational factor moderation (compared to zero order correlation coefficient of role of financial intermediaries and SME performance $r_{xy.}$=0.764**	**Significance (p-value) (p=0.05,2 tailed)**
Management of SME's	0.774	Slightly positive	0.000
Capital Base	0.785	Slightly positive	**Overall significance = 0.000**

Source: Research Data 2014

The results indicate that $r_{xy.z1}$ =0.774, p≤0.05, r_{xyz2}=0.785, p≤0.05. The results in Table 4.16 suggests that on the whole, organizational factors significantly moderate the relationship between financial intermediation and SME's performance (overall significance=0.000). To test the effect of each moderating variable, the study used first order partial correlation where each moderating factor is used as a control variable. The results generate an 'r' value which is then compared with the r= 0.764 p≤0.05 got from the zero order partial correlation (multiple regression in table 4.15 above). From the results in table 4.15 above, when capital base is used as a control variable, r=0.785, p≤ 0.05 and management style as a control variable, r=0.774, p≤ 0.05. This showed that capital base had a more moderating effect on the relationship between role of financial intermediaries and performance of SME's than management style in summary, we reject the null hypothesis $H_0$4 since $r_{xy.z1} \neq r_{xyz2}$ since 0.774≠0.785. Hence the study concludes that organizational factors have a moderating effect on the relationship between role of financial intermediaries and performance of SME's.

The following table shows the summary of analytical testing and regression model.

Table 4.17: Hypothesis Testing Framework and Analytical Model

Hypothesis	Hypothesis Test	Rules	Decision
$H_0$1: Liquidity (L) has no effect on the performance of SME's (P) in Kakamega Town	Karl Pearson's zero order coefficient of correlation(Beta test)	Reject H01 if $\beta1 \neq 0$, $P=\alpha+\beta1L+e$ $\beta1 = 0.753 \neq 0$	Rejected the null hypothesis
$H_0$2:Risk diversification(RD) has no effect on the performance of SME's(P) in Kakamega Town	Karl Pearson's zero order coefficient of correlation (Beta test)	Reject H02 if $\beta2 \neq 0$ $P=\alpha+\beta2RD+e$ $\beta2=0.697 \neq 0$	Rejected the null hypothesis
$H_0$3: Pool savings (ps) has no effect on the performance SME's (P) in Kakamega Town	Karl Pearson's zero order coefficient of correlation (Beta test)	Reject H03 if $\beta3 \neq O$ $P=\alpha+\beta3ps+e$ $\beta3=0.731 \neq 0$	Rejected the null hypothesis
$H_0$4: Organizational factors have no moderating effect on the relationship between financial intermediation and performance of SME's in KakamegaTown	First order partial correlation coefficient (rxy.z)	Reject H04 if rxy.z1≠rxyz2…≠rxy.zn ≠rxy. $\beta4=764 \neq 0$ $P=\alpha+\beta4OF+e$	Rejected the null hypothesis

Source: Research Data 2014

4.9 Qualitative analysis for the interview guide

An interview schedule was used to collect in depth information from the managers and the acting managers. This instrument was used because it enabled the researcher to obtain very detailed information, guided the respondents in the right direction and also made it possible to obtain data required to meet specific objectives of the study hence increasing precision.

The respondents cited that some of the services they got from the financial institutions included access to finance, risk diversification and pool savings. Some of the SME's received information from the financial institution however only afew of them saved their money with the same institutions.

All the managers and the acting managers agreed that access to finance is a major aspect in the growth of SME's. Managers from smaller SMEs had this to say: 'We prefer using our retained earnings to run the business and finance our own investments'. The larger SMEs had also this to say: 'We have difficulties in growth due to lack of finances to meet our needs at different levels of growth. 'From the response it was established that there was difficulty in accessing credit offered by financial intermediaries due to the high interest rates, collateral requirements, high and multiple transaction cost and the strict terms that normally go along with the loans. However managers from rather small SME's tend to think differently from their counterparts in larger SME's as they argued that they could easily run their business without having to rely on the financial institutions for credit.

Majority of the managers agreed that risk diversification indeed affected the performance of SME's. They noted that risks are increasing and risk management is an integral part of

any organization. This is what majority of the managers had to say ‘We would rather avoid risk rather than devise risk control methods’. Others said ‘We make very little profit. How do we start investing in other business?’ From the sentiments it is clear that the managers are not versed in the availability and use of risk techniques to reduce the adverse effect of risks on their enterprises. It was evident that limited resources and weak structural features made SMES’s vulnerable to the harmful effects of risks. A few of the managers did not embrace this concept of risk diversification since they were operating under very minimal amount of capital.

The participants revealed that pool savings is motivated by rates of return on capital investment and availability of investment opportunities, in which most SME’s did not have information pertaining to investment opportunities. Majority took on bad investments eventually resulting to a low return on investments, hence very little or nothing to save. Few of the responses from the participants: ‘The amount of money we make is just enough to run the business and meet our daily expenses. At the end of the day there is little left that can be used to make other investments. ‘We rarely get any information from financial institutions regarding the best investments to undertake. Consequently we end up taking on bad investments incurring heavy losses’.

CHAPTER FIVE:
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the study findings, conclusions, and the recommendations made from the findings of the study. It also presents the suggestions for further researches.

5.2 Summary of the Findings

The items mean and standard deviation measuring level of agreement were computed from the respondent's response. The descriptive statistics thus shows the respondent's views on the effect of the role of financial intermediaries on the business performance of small and medium enterprises in Kenya. From these results, the overall mean of role of financial intermediaries are all above 4, significantly showing that there is an agreement of the respondents to the fact that the roles played by financial intermediaries have an effect on the business performance of SME's in Kenya. An overall standard deviation of less than 1 further confirms that indeed the means represent the general level or true measure.

The inferential statistics showed that there was a positive correlation among the independent variables. Consequently the results indicated a statistically positive correlation between the independent variables i.e. roles of financial intermediaries and the dependent variable i.e. performance of SME's.

The results from the hypothesis testing, showed that the relationship between the independent variables and the dependent variable followed a simple regression model of the nature $P=\alpha+\beta x+e$ where P is the performance of SME's, (dependent variable) α is the

constant intercept and x is independent variable. It was further revealed from the study that $\beta \neq 0$ and was significant at $p \leq 0.05$. In conclusion all the objectives were achieved since the independent variable had an effect on the dependent variable. The moderating variable as well had a positive effect on the relationship between the independent variable and the dependent variable.

The study showed that the financial intermediaries played a significant role by offering banking services and extending credit facilities to SME businesses. Other support offered by financial intermediaries included; offering liquidity, risk diversification and pool savings. The study revealed that the existing evaluation procedures adopted by financial intermediaries were a big hindrance to these services because they were stringent and bureaucratic. Evaluation procedures made it difficult for businesses to access support from financial institutions. The existing evaluation procedures wasted a lot of business time and made financial intermediaries' services inaccessible to most businesses. Based on the statistical analysis performed, it can be concluded that the most significant aspects of financial intermediaries that affected the growth of SMEs included; liquidity, risk diversification and pool savings. These were found to have contributed significantly to the growth of SMEs. SMEs evaluation procedures were found not to have contributed to the current growth of SMEs hence the need to revise the existing financial intermediaries' evaluation procedures. This will therefore contribute to the growth of SMEs in the region in the long run.

The following were the general objectives of the study; to determine the effect of liquidity on the performance of SME's, to determine the effect of risk diversification on the performance of SME's, to determine the effect of pool saving on the performance SME's

and to determine the moderating effect of organizational factors on the relationship between roles of financial intermediaries and performance of SME's in Kakamega Town. Data collection regarding the role of financial intermediaries on the performance of Small and Medium enterprises, SME's, was undertaken using a survey questionnaire developed by the researcher. An interview guide was also used to collect primary data from lead worker, managers and acting managers where specific information regarding the study was required.

All statistical tests were performed using Microsoft EXCEL 2003 and SPSS version 20 software programs. The questionnaire return rate was 96.4% since 400 questionnaires were returned out of 415 that were supplied. The response rate of at least 90% was considered a good rate according to Saunders et al. (2007).

The role of financial intermediaries was the independent variable on the conceptual framework shown in Figure 1.1. The constructs under financial intermediaries were; liquidity, risk diversification and pool saving. These variables were analyzed through dimension reduction of factor analysis and their mean were then computed and further used in the study. There were several questions that aimed at establishing from the respondent show liquidity affected the performance of SME's. The respondents were asked to score the questions that were rated on the five (5) point Likert scale ranging from 1=Strongly Disagree, 2=Disagree, 3=Neither Agree nor Disagree, 4=Agree, and 5=Strongly Agree.

Inferential statistics helped the research study to establish the relationship between the variables under study. The constructs under role of financial intermediaries were liquidity, risk diversification and pool savings. The questions regarding each construct were grouped together through factor reduction and their mean was used to in finding out the relationship among them (correlation).

From the results it shows that liquidity had a statistically significant positive correlation ($r=0.723$ and $p\leq0.05$) with risk diversification. Liquidity had a statistically significant positive correlation ($r=0.613$ and $p\leq0.05$) with pool saving. Risk diversification had a statistically significant positive correlation ($r=0.735$ and $p\leq0.05$) with pool savings. On the overall, there is statistically significant positive correlation among the various roles played by financial intermediaries. The results indicate that when one role was positively affecting performance of SME's, the other two were also affecting performance.

The organizational factors which were moderating variable in the study included the management style and capital base. The results indicate a statistically significant positive correlation between management style and capital base ($r=0.784$, $p\leq0.05$). This implies that as one factor was having a positive moderating effect on the relationship between the financial intermediation and performance of SME's, other factor was as well having the positive moderating effect at the same time.

The central thesis of this research was to establish the role of financial intermediaries on the performance of SME's in Kakamega Town. The specific objectives were changed to null hypotheses as follows; the study employed zero order and first order partial correlation

to establish the effect of the variables. These hypotheses were tested at 0.05 % significance level, with 95% confidence, which is acceptable in non–clinical research works. The analysis was done as follows:

In order to determine whether liquidity had any effect on the performance of SME's in Kakamega Town, the study set out the following hypothesis;

H01: Liquidity has no effect on the performance of SME's in Kakamega Town. The study used the correlation r (beta, β) to test this hypothesis. The test criteria is set such that the study rejects the null hypothesis H01 if $\beta 1 \neq 0$. To test the hypothesis, the mean of business performance (P) was correlated with the mean of liquidity (L). The correlation results between the mean of liquidity and the mean of SME's performance (P) had a beta term $\beta 1=0.630$ at $p=0.05$. In the hypothesis criteria, we were to reject H01 if $\beta 1 \neq 0$. However, from this results, the value of beta $\beta 1=0.753$ and yet $0.753 \neq 0$. The study therefore rejects the null hypothesis and concludes that liquidity has a statistically significant positive effect on the performance of SME's in Kakamega Town. This correlation results above show that liquidity has a positive effect on the performance of SME's. The results further indicated that 56.7% of the SME's performance can be explained by liquidity ($r2=0.567$) and the relationship followed a simple regression model of the nature $P=\alpha+\beta 1L+e$ where P is the SME performance, α was the constant intercept of which in our case was 2.030 and beta $\beta 1=0.753$, L was liquidity and e was the standard error term.

In order to determine whether risk diversification had any effect on the performance of SME's in Kakamega Town, the study set out the following hypothesis;

H02: Risk diversification has no effect on the performance of SME's in Kakamega Town. The study used the correlation r (beta, β) to test this hypothesis. The test criterion is set such the study rejects the null hypothesis H02 if $\beta 2 \neq 0$. To test the hypothesis, mean of business performance (P) was correlated with mean of risk diversification (RD). The correlation results between the mean of risk diversification and the mean of SME's performance (P) had a beta term $\beta 2=0.697$at $p=0.05$. In the hypothesis criteria, we were to reject H02 if $\beta 2 \neq 0$. However, from this results, the value of beta $\beta 2=0.697$ and yet $0.697 \neq 0$. The study therefore rejects the null hypothesis and concludes that risk diversification has a statistically significant positive effect on the performance of SME's in Kakamega Town. This correlation results above show that risk diversification has a positive effect on the performance of SME's. The results indicate that 48.6% of the SME's performance can be explained by risk diversification ($r2=0.486$) and the relationship followed a simple regression model of the nature $P=\alpha+\beta 2RD+e$ where P is the SME performance, α was the constant intercept of which in our case was 2.195 and beta $\beta 2=0.697$, RD was risk diversification and e was the standard error term.

In order to determine whether pool saving had any effect on the performance of SME's in Kakamega Town, the study set out the following hypothesis;

H03: Pool savings has no effect on the performance SME's in Kakamega Town. The study used the correlation r (beta, β) to test this hypothesis. The test criterion is set such the study rejects the null hypothesis H03 if $\beta 3 \neq 0$. To test the hypothesis, mean of business performance (P) was correlated with mean of pool saving (ps). The correlation results between the mean of pool saving and the mean of SME's performance (P) had a beta term $\beta 3=0.697$ at $p=0.05$. In the hypothesis criteria, we were to reject H03 if $\beta 3 \neq 0$. However,

from this results, the value of beta β3=0.731 and yet 0.731≠0. The study therefore rejects the null hypothesis and concludes that pool saving has a statistically significant positive effect on the performance of SME's in Kakamega Town. These correlation results above show that pool saving had a positive effect on the performance of SME's. The results indicate that 53.4% of the SME's performance can be explained by pool saving (r2=0.534) and the relationship followed a simple regression model of the nature P=α+β3ps+e where P is the SME performance, α was the constant intercept of which in our case was 1.966 and beta β3=0.731, ps was pool saving and e was the standard error term.

The study established the moderating effect of organizational factors using first order partial correlation. Afterwards, the partial correlation coefficients were then compared with the simple coefficients generated from the direct zero order partial correlation of financial intermediation and performance of SME's (r=0.764) in order to determine the magnitude and direction of the moderating effect of the organizational factors. To get this end, the following null hypothesis was constructed to carry out the test H04. Organizational factors have no moderating effect on the relationship between financial intermediation and performance of SME's in Kakamega Town. We reject H04 if rxy.z1≠rxyz2≠rxy.zn≠rxy., given P=α+ β4OF+e. The results indicate that rxy.z1= 0.776,p=0.000, rxyz2 =0.785, p=0.000. The results above suggests that on the whole, organizational factors significantly moderate the relationship between financial intermediation and SME's performance (overall significance=0.000). However, for instance, the management style of SME's has a significant positive moderating effect on the relationship between role of financial intermediaries and performance of SME's

(rxy.z=0.774, p=0.000). In other words, the relationship between role of financial intermediaries and performance of SME's will be higher if management style is good. In summary, we reject the null hypothesis H04 since rxy.z1≠rxyz2.

5.3 Conclusions

The research concludes that all the independent variables that were tested in this study liquidity, risk diversification and pool savings have a relationship with the performance of SMEs. The study further indicates that the variables liquidity, risk diversification and pool savings have a positive relationship with the performance of SMEs. The conclusion is supported by the results from the descriptive statistics and inferential statistics.

The study supports past literature which reveal that liquidity has a positive effect on the performance of SME's. The studies reveal that financial markets direct the flow of funds from savers to investors, by bringing buyers and sellers together, therefore affecting the wealth of individuals and how businesses behave, and the entire economy. In so doing, financial markets facilitate economic efficiency, and economic growth. Funds can be transferred by the financial market from savers to borrowers through direct transfers, investment bankers or use of intermediaries.

In the second objective, the results of this study are in line with past literature which reveals that risk diversification has a positive effect on the performance of SME's. Past literature reveals that Low transaction costs enable financial intermediaries to share risks through asset transformation; the process by which financial intermediaries turn risky assets into safer assets for investors by selling and creating assets, which have lower risks and turn

by the assets associated with more risks. The financial intermediaries also assist persons as well as business in diversifying their asset holdings, by buying a wide range of assets which they group and then sell the rights of the diversified groups to individuals.

In the third objective, the study is also in line with past studies which reveal that pool saving had a positive statistically significant effect on the performance of SME's. Past literatures reveal that depositors are also able to receive interest on their savings and checking accounts, and they also have the freedom to change the finances into goods or services at any time they feel it is essential to do so.

The study established a statistically significant positive moderating effect of organization variables on the relationship between role of financial intermediaries and performance of small and medium enterprises. Management style was one of the constructs under organizational factors. There are various styles of management which include Autocratic, Democratic, Participative, Laissez Faire. An autocratic manager makes decisions without consultations, they dictate and like being in control of situations. This style of management leads to work getting done on time because there are less people involved in the decision making process and is best where on the spot decisions needed. Opinions that the problem with this style is that staffs are not motivated and employees' turnover is likely to be high. A democratic manager delegates work to his staff. Since many people are involved in decision making, the work is likely to be slow. In a democratic style, the manager allows the employees to take part in decision-making: therefore everything is agreed upon by the

majority. Consultative/Participative Management Style involves getting lots of feedback from one's staff before coming to a conclusion and making a decision.

The second construct under organizational factors was capital base. The study results is in agreement with past studies which reveal that large firms are more likely to exploit economies of scale and enjoy higher negotiation power over their clients and suppliers. In addition, they face less difficulty in getting access to credit for investment, have broader pools of qualified human capital, and may achieve greater strategic diversification. On the other hand, small firms exhibit certain characteristics which can counterbalance the handicaps attributed to their smallness. They suffer less from the agency problem and are characterized by more flexible non-hierarchical structures, which may be the appropriate organizational forms in changing business environments.

5.4 Recommendations

The following recommendations were made based on the findings and conclusions of the study;

i. Small and medium enterprises should aggressively engage in ensuring their businesses have enough cash cover. The study reveals that there is a statistically significant positive effect between liquidity and performance of SME's

ii. Small and medium enterprises should engage in risk diversification. They should engage in different types of businesses since this will enable them to spread their risks. Risk diversification has a positive bearing on the performance of SME's

iii. Small and medium enterprises should actively engage in pool saving. The study established that there is statistically significant positive effect of pool savings on the

performance of SME's. Through pool saving, SME's will increase their capital base hence have enough money to make more investments and they will also earn interest from their deposits.

iv. Small and medium should actively engage in analyzing the organization factors since these factors have a positive moderating effect on the relationship between role of financial intermediaries and performance of SME's.

5.5 Suggestions for Further Research

The following suggestions were made for further research based on the findings of this study. The study was done in Kakamega Town, which is found in Kakamega County. Further research is encouraged to have other counties also covered in the whole country to see whether the results are still the same. There are several other organizational factors that can be used as moderating factors; they include age of firm, nature of business, and information technology among others. Future research is required to explore more extensively and should include such factors to investigate if the results are still the same. In future a comparison should be done between the financial performance of SMEs that have not embraced financial intermediation and the ones that have not. This may help in shedding light on whether embracing financial intermediation helps the SMEs to perform better than those that have not.

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APPENDICES

Appendix I: Introduction Letter

The Respondents

Kakamega Town

Kakamega, Kenya

Dear Sir /Madam,

RE: COLLECTION OF DATA

I am a student at Masinde Muliro University of Science and Technology, pursuing Masters of Business Administration (Finance option). I'm currently undertaking a research project on **"EFFECT OF FINANCIAL INTERMEDIRIES ON THE PERFORMANCE OF SME's IN KAKAMEGA TOWN, KENYA"** which is a requirement so that I can be awarded my master's degree. I'm therefore seeking your assistance to fill the questionnaires attached.

All the information given will be held confidential and will only be used for educational purposes.

Kind regards

Yours faithfully,

GRACE MUMBI WAWERU

Appendix II: Questionnaire

Introduction

This questionnaire seeks to gather information on the impact of financial intermediation and performance of SME's. Please spare your 5-10 minutes to answer questions relevant to you, all information you provide will be treated with utmost confidentiality and will be completed anonymously. Thank you for your contribution.

Section 1: **Background Information**

Put a tick **(√)** in the appropriate box.

1. Please indicate your gender

   Female ☐

   Male ☐

2. Indicate your age bracket

   20-30yrs ☐

   31-40yrs ☐

   41-50yrs ☐

   51 and above ☐

3. Provideyour highest level of education

   Primary level ☐

   Secondary level ☐

   CollegeUniversity ☐

   Postgraduate ☐

   Professional ☐

   Qualification

4. Please indicate the number of years you have worked as an SME?

Less than 5 Years ▫ 5-10 Years ▫ Over 10 Years ▫

Section B: Role of Financial Intermediaries

(That is, role played by financial institutions, like banks)

5. Do you understand the term financial intermediary?

Yes ▫

No ▫

6. Do you have an account in any financial institution?

Yes ▫

No ▫

7. Do the financial institution encourage you to save regularly?

Yes ▫

No ▫

8. Do the financial institutions allow you to borrow for purposes of expanding your business?

Yes ▫

No ▫

9. Do you think that financial institutions play a noble role in how your businesses operate?

Yes ▫

No ▫

In this section, please tick (√) the most appropriate response for each of the questions in the table below with the scores in the bracket.

Strongly Agreed (SA) = 5; Agree (A) = 4; Undecided (U) = 3;

Disagree (D) = 2; and Strongly Disagree (SD) = 1

Question		**SA**	**A**	**U**	**D**	**SD**
	Liquidity					
10	SME's maintain active accounts with their banks and other financial institutions like Saccos which improves the performance of SME's					
11	SME's receive loans from the financial institutions like banks among others which improves their performance					
12	SME's receive varieties of credit facilities from banks to improve on their capital base					
13	The SME's repay their credit facilities on time and still manage to run their businesses					
	Risk Diversification					
14	Resources, risk management skills and weak structural features make SMEs vulnerable to harmful effects of risk					
15	Amount of capital determined the number of investments to make					
16	SME's are guided by financial institutions on how to make investment which positively					

	affects performance					
	Pool Saving					
17	Financial institutions enables SME's to have a platform where they can save regularly					
18	SME's are not worried of their savings getting lost because the banks provide them the surety.					
19	SME's are advised on the importance of pool savings to their business performance					
20	Pool saving has a positive effect on the performance of SME's					

Section C: Organizational Factors

In this section, please tick (√) the most appropriate response for each of the questions in the table below with the scores in the bracket.

Strongly Agreed (SA) = 5; Agree (A) = 4; Undecided (U) = 3;

Disagree (D) = 2; and Strongly Disagree (SD) = 1

Question		**SA**	**A**	**U**	**D**	**SD**
21	SME'sare managed by people who have the required skills in management which improves the performance of businesses					
22	Good management style increases customer loyalty					
23	Most of the SME's receive formal training in the relevant areas of business					
24	SME's with better managers performs better than those without					
25	The performance of a business is greatly affected by how it is managed					
	Capital Base					
26	The higher the capital base of SME's the higher their performance					
27	An SME without enough capital to run the business cannot operate well and hence performance is affected					

28	Availability of capital has a great influence on the performance of SME's					
29	Capital base affects performance of SME's positively					
30	Generally businesses with low capital base perform poorly as compared to those with high capital base					

Appendix III: Interview Schedule

Introduction:

Hall to you Sir/Madam,

Thank you for having granted me permission to interview you. I would like to assure you that I will stick to all ethical codes of conduct with regard to conducting research as stated in my introduction letter. I am carrying out a research on the impact of financial intermediation and performance of small and medium enterprises in Kenya.

The Interview Questions:

i. Identify some of the financial services acquired from the banks within your organization

ii. What is your opinion in regards to liquidity on the performance of your organization?

iii. What is the effect of risk diversification on the performance of your organization?

iv. What is your take on pool savings as offered by financial intermediaries on the performance of your organization?

v. In your view is there a moderating effect of the organizational factors (management style and capital base) on the relationship between role of financial intermediaries and performance of your organization? Explain.

Appendix IV: A Map Showing the Study Area

Appendix V: Research Authorization

NACOSTI

NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY AND INNOVATION

Telephone: +254-20-2213471, 2241349, 310571, 2219420
Fax: +254-20-318245, 318249
Email: secretary@nacosti.go.ke
Website: www.nacosti.go.ke
When replying please quote

9th Floor, Utalii House
Uhuru Highway
P.O. Box 30623-00100
NAIROBI-KENYA

Ref: No.

Date:

13th July, 2015

NACOSTI/P/15/1082/6551

Grace Mumbi Waweru
Masinde Muliro University of
Science and Technology
P.O. Box 190-50100
KAKAMEGA.

RE: RESEARCH AUTHORIZATION

Following your application for authority to carry out research on ***"Role of financial intermediaries on the performance of Small and Medium Enterprises in Kakamega Township, Kenya,"*** I am pleased to inform you that you have been authorized to undertake research in **Kakamega County** for a period ending **30th October, 2015.**

You are advised to report to **the County Commissioner and the County Director of Education, Kakamega County** before embarking on the research project.

On completion of the research, you are expected to submit **two hard copies and one soft copy in pdf** of the research report/thesis to our office.

DR. S. K. LANGAT, OGW
FOR: DIRECTOR-GENERAL/CEO

Copy to:

The County Commissioner
Kakamega County.

The County Director of Education
Kakamega County.

National Commission for Science, Technology and Innovation is ISO 9001: 2008 Certified

Appendix VI: Permit

THIS IS TO CERTIFY THAT:
MS. GRACE MUMBI WAWERU
of MASINDE MULIRO UNIVERSITY,
0-50100 KAKAMEGA,has been permitted
to conduct research in *Kakamega County*

on the topic: *ROLE OF FINANCIAL INTERMEDIARIES ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KAKAMEGA TOWNSHIP, KENYA*

for the period ending:
30th October,2015

Permit No : NACOSTI/P/15/1082/6551
Date Of Issue : 13th July,2015
Fee Recieved :Ksh 1,000

.....
Applicant's Signature

.....
Director General
National Commission for Science, Technology & Innovation

Appendix VII: Permit

CONDITIONS

1. You must report to the County Commissioner and the County Education Officer of the area before embarking on your research. Failure to do that may lead to the cancellation of your permit
2. Government Officers will not be interviewed without prior appointment.
3. No questionnaire will be used unless it has been approved.
4. Excavation, filming and collection of biological specimens are subject to further permission from the relevant Government Ministries.
5. You are required to submit at least two(2) hard copies and one(1) soft copy of your final report.
6. The Government of Kenya reserves the right to modify the conditions of this permit including its cancellation without notice Russell

HARAMBEE

REPUBLIC OF KENYA

NACOSTI

National Commission for Science, Technology and Innovation

RESEARCH CLEARANCE PERMIT

Serial No. A 5771

CONDITIONS: see back page